



Economic Affairs / *A Monthly Analysis*

A special supplement to CHALLENGE

June 1, 1961

THE UPWARD CLIMB seems to have started, but from here it looks like a slow and uneven one. The signals are still mixed. Unemployment hangs around a sticky 6.8%. What is worse, the number of people out of a job for more than 15 weeks is at a postwar record of 2.1 million.

Unemployment will continue to be a problem as the recovery proceeds. The war babies are entering the labor market at the same time that new labor-saving machinery is being introduced. The government now considers 4% as a normal level of unemployment and hopes to reach this target some time in 1962.

There were 2 main sources of strength for the economy during the recession. One of these lay in foreign trade. Net exports of goods and services more than doubled between the second and fourth quarters of 1960, rising from an annual rate of \$2 billion to \$4.6 billion. This occurred not so much because we sold more to foreigners—our total exports rose by only an annual rate of \$600 million—but because we cut our imports by \$2 billion.

The other chief support lay in government purchases of goods and services. Between the second and fourth quarters of 1960 federal purchases rose by an annual rate of \$2.1 billion. Most of the increase was for national defense purposes. State and local governments did their part by increasing their expenditures at a rate of \$1.9 billion per year.

Consumer spending remained relatively stable. The big drop in spending in the U.S. came in private business investment. Between the middle and end of 1960 the drop was at an annual rate of \$9.5 billion. It is pretty clear now that the full impact of this cutback was cushioned largely by the increase in government spending.

What now? Government spending is likely to remain high. Consumers are beginning to borrow more, indicating a willingness to increase their purchases. The purchasing policies of businessmen are changing. New orders are rising and backlogs of unfilled orders are beginning to increase. Even the troubled steel industry is nearing 70% of capacity operations.

Gross national product reached its low point for the recession during the first quarter, when it touched \$499.5 billion. That's 1% below its previous peak. The second quarter is likely to show a rise to \$505 billion.

Only a sharp increase in spending for new plant and equipment can give us a vigorous and healthy boom. That's not in sight at this time. Still, some hope can be gleaned from the latest McGraw-Hill survey of capital expenditures. While industry plans to spend less this year than next year, the rate of spending will have to rise considerably over that of the first quarter if this year's spending goals are to be met. Happily we know from experience that businessmen tend to underestimate their spending at the beginning of an upswing.

SPECIAL CORRESPONDENCE—Clearing a path toward the New Frontier has plenty of hazards, as anyone working for the Kennedy Administration can testify after 4 months of responsibility. What should be done often seems plain enough when one is not in office. But the pressures that come to bear after one is in power frequently alter conceptions of what can be done.

For example, before they assumed their present posts, neither Adolph Berle nor Arthur Schlesinger viewed the Cuban problem in terms of keeping peace among the various rebel factions—something they were asked to do in the midst of the abortive attempt to overthrow Castro.

Also, President Kennedy's recent call for self-restraint on the part of the press was something that he had not thought too much about until faced with the reality of being criticized for failure in the Cuban affair.

As for the unfavorable press that CIA got for all its troubles in Cuba, it is unfair to overlook the fact that the Agency had been saddled with too much responsibility in the first place. Collecting and analyzing information is one thing. Being responsible for coordinating the forces of emigre groups is quite another. This dual job, plus the knowledge that some kind of intervention was considered desirable by past and present Administrations, was too much of a load for one Agency to carry.

The honeymoon between the Federal Reserve Board and the Kennedy Administration will last only as long as the recession is officially with us. Reports are that the Reserve authorities are ready to clamp down the credit lid at the first signs of "recovery" inflation. This runs counter to the desires of the Kennedy people to keep money loose as a means of spurring the growth rate. Federal Reserve Chairman Martin's term still has 2 years to go.

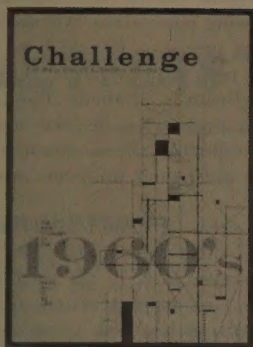
The Administration's proposal to tax the unrepatriated profits of U.S. concerns with overseas branches in developed areas has raised the cry of "foul" among many business circles. Many such branches were set up during the postwar years because the government offered tax advantages. Now, with established businesses at stake, the government wants to change the rules of the game. Today, because of foreign policy considerations, the government wants to encourage businesses to go into the underdeveloped areas.

In this connection, the U.S. plea that West Germany help share the burden of assisting underdeveloped areas has thus far brought forth no positive action. Economics Minister Erhard did, however, conclude an economic cooperation agreement with Spain: German capital for Spanish industries and long-term loans to pay for imported German goods.

Sen. Kefauver is calling for stiffer criminal penalties for those convicted of price fixing. Business groups find themselves in the unenviable position of publicly opposing price-fixing practices and privately resenting the idea of being the whipping boys because of the recent "scandals."

The basic assumption of criminal procedures against price fixing is that perfect competition exists in today's economy—which it does not. Neither buyers nor sellers are actually free to bargain for a "just" price.

Mass production, mass distribution and mass consumption have unleashed a set of forces that the 18th-century theorists of free competition did not have to contend with. Bigness in business, labor and government is an unavoidable fact of modern life. This being the case, it is necessary to determine first what kind of competition we want to protect and encourage before setting a penalty for violators.



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Challenge

THE MAGAZINE OF ECONOMIC AFFAIRS

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THE SIXTIES

THE AFFAIRS of a nation ride on the momentum of past events. Therefore, one might say that the current performance is almost always slightly behind the times. This is particularly true of an orderly and stable society that does not wish to indulge in the oversights of revolutionary action.

There are, however, periods in the development of even the most politically stable nation when the momentum of earlier conditions has obviously petered out, and it becomes apparent that a new array of forces must be recognized and analyzed as possible sources for a new momentum in a new phase of development. The year 1960 brought the postwar era to a close. General recognition that a new era lay ahead came in 1961. This is why the over-all theme of this issue of *CHALLENGE* is "The New Economy of the 1960s."

It should be expected that any new era will bring with it a need for a change in pace, a coterie of new problems requiring a fresh look, a host of new challenges that need not obliterate the opportunities that accompany every new situation. Admittedly, a society that stands at the end of an old trail and at the start of a new is as close to taking the first wrong steps as to taking the first right ones. The mathematical odds are 50-50—right move or wrong move—if matters should be left completely to chance. Somewhat more favorable odds pertain if knowledge, forethought and imagination are exercised.

It is difficult to put a single descriptive label on the decade of the Sixties because no man has such powers of vision that he can plainly see the future. But surely even the most myopic observer can distinguish between what is over and done with and the raw materials that are available to shape the future. This is all the discernment we have to have, and all that we will ever have to influence our destiny.

The postwar splurge is over. Many of our material needs have lost their pent-up quality. The consumer is reappraising his spending habits. Capital expansion of basic industries has reached surplus proportions. The wage and cost push-pull axis has been exposed. The U.S. dominance of the international economic scene has ended. In short, the notion has finally got around that the catchwords, habits and procedures of 15 postwar years have lost their old generative effect and that some kind of altered posture in approaching the Sixties is definitely indicated.

What all this amounts to is the realization that we

can no longer avoid some old problems and that we can no longer afford not to take advantage of approaching opportunities. This nation has the basic ingredient of growth—namely, a growing population. All we have to do is to keep on finding new ways by which we can produce for and service each other's needs. This is basically what economic growth is all about. The trouble is that we can, and at times have, become bogged down with certain trouble spots on the economic scene that tend to be neglected until their problems assume dramatic proportions.

We have had depressed areas for more than 20 years, but national attention to them came only when the chronically unemployed loomed large in the unemployment statistics of this last and most persistent of the postwar recessions. Automation has been moving into production industries for well over a decade, but its impact on a certain category of employment did not make the headlines until unemployment hit 5.5 million and stubbornly resisted a downward trend. Thoughts about where the new entrants into the labor force could find jobs were not widespread until two million workers each year started looking for new opportunities armed with skills acquired under old concepts.

The possibility of persistent U.S. deficits in dealings with other countries was indicated as early as 1950, but it wasn't until 1959, when the deficit was in excess of \$4.5 billion, that we became aware of the considerable change in the international economic status of the United States.

... and their impact

Thus, the change, and the need for change, took on the proportions of a rude awakening only relatively recently. What brought about the change is relevant to any consideration of what should be done about it. No 10 articles in any one issue of a magazine could explore all the problems of a transitional period and all the possibilities open to a society within the framework of certain established and respected institutions. What we have tried to do in this issue of *CHALLENGE* is to present the high spots from which one can begin to see the shape and meaning of the new economy of the Sixties.

Finally, there are two significant aspects of American ideology on which the problems and prospects of the Sixties are bound to make an impact. First, whatever course of action we choose to take is going to affect our traditional understandings of how resources are to be allocated. We may find that the word "freedom" is to be defined more and more as something relative to other values that will have to be considered. Second, because of the international setting, the programing of national goals will be workable only if we make the most of the dynamic aspects of our federal form of government.—H. B.

LETTERS TO THE EDITOR

CHALLENGE invites your comments. Address letters to
CHALLENGE, 475 Fifth Avenue, New York 17, N. Y.

RUBLES AND DOLLARS

• In the article, "Moscow's Motives" [April, 1961], Prof. Franklyn D. Holzman states Moscow's credits to foreign governments as though made in dollars. Although he makes these statements without qualification, I assume that Moscow extended no dollar credits at all, but ruble credits. These ruble credits Prof. Holzman has converted into dollars at some ratio selected by him. But I am unable to find any statement as to the ratio.

There is also another factor bearing upon the question of comparisons that I would like to know more about. A ruble credit means that a debtor is permitted to buy things produced by the seller at prices fixed by the seller, there being no competition. Did Prof. Holzman attempt to make calculations of any sort to allow for this difficult but nevertheless important factor?

WILLIAM CHAMBERLAIN

Saratoga, Calif.

► Mr. Chamberlain has asked a good question and one that I should, perhaps, have elaborated on in my article. My figures on Soviet credits were built up primarily from two sources: U.S. government estimates up to 1959 and my own estimates for 1960. The government estimates were published in dollar terms but were presumably converted from rubles at the official (until January 1, 1961, when the ruble was revalued) four rubles equal \$1 exchange rate; my own estimates were based on Soviet ruble figures and were converted to dollars at the same exchange rate.

This is a fairly valid procedure for the following reason. The Soviet domestic price level has been so far out of line with world prices at the four to one exchange rate that the Soviets have tended to negotiate all their foreign trade transactions at world or dollar prices. For example, the domestic price of the little Russian automobile, the Moskvich, was 25,000 rubles in 1959. When the Soviets attempted to sell it in the U.S. in the same year, it was priced at \$1,400, or competitive with the Volkswagen, rather than at \$6,250, which is the domestic price converted

to dollars at four to one. Similarly, the Soviet foreign trade returns would show the sale of a Moskvich at 5,600 rubles, which is \$1,400 converted to rubles at the official four to one exchange rate.

I have compared the foreign trade ruble prices of about 100 commodities exported and imported by the Soviets in 1956 with the U.S. foreign trade prices of the same commodities and found that the four to one ratio generally holds.

What does this imply? It implies that the value of Soviet trade or aid translated from rubles into dollars at the official exchange rate provides a fairly accurate indication of the true value of the transaction. I would not exclude the possibility, however, that in any particular instance the true value of the transaction might be under- or overstated. As I said in my article: "Most of the major Soviet credit agreements provide for future negotiations to determine the commodities in which repayment is to be made, and their prices. While it is too soon to judge, hard bargaining over the specifics of repayment obviously could enable the Soviets to recoup some of the losses involved in their low-interest terms."

So far, I should add, there has been no indication that the Soviets are bargaining "hard." And this makes sense in terms of the analysis of my article: since aid is largely politically motivated, it would not be particularly rational for the Soviets to sacrifice the political capital earned by advancing credits for small economic gains.—FRANKLYN D. HOLZMAN.

INTERPRETING MARX

• Sidney C. Sufrin's article, "Is History on the Side of the West?" [April, 1961] interested me very much. It has always seemed to me that the doctrine of the inevitability of social change as taught by Marx has been proven by the events of history.

But that doesn't mean that Western society is doomed—as Mr. Sufrin has so graphically pointed out. It may be doomed to change, yes, but ordered change is nothing to fear. Rather, it should be welcomed. Initiative *does* lie

on the side of the West—if we can only put our house in order in time to influence the direction of the change (also inevitable) taking place within the Communist bloc.

TED WALTERS

Washington, D.C.

• What a novel interpretation of the Marxist dialectic! The Western world has changed so radically in this century, sunnily speculates Mr. Sufrin, that it is the West who will force change on the East instead of vice versa.

I don't see how anyone can think that the winds of social change which have blown across the Communist world—and which are now blowing across many of the neutral nations of Latin America, Africa and Asia—are about to change direction. The struggle against poverty in the underdeveloped areas of the world has just begun. These countries are hardly in a position to inflict change on the Communist world. Nor are we—unless we can prove with actions as well as words that free enterprise can bring "the good life" to the world's poor. Inasmuch as we have not yet proved this point (though free enterprise has existed for centuries), I can't see much hope that Communism (not yet 50 years old) is doomed to fold first.

If you ask me, initiative lies in the hands of the East!

PAULA DEANE

Providence, R.I.

ON "THE GOOD LIFE"

• Congratulations on the profound and lucid article by Harry W. Pearson, "Is the Good Life Here?" [March, 1961]. In my personal view this is one of the most objective, and fundamental, considerations of both the limited and unlimited implications of economic factors which are operative in our society today.

JUDSON CHRISNEY

Director, Development

National Planning Association

Washington, D.C.

COLOR TV

• Your April issue made for most interesting reading. I especially enjoyed the article by Fredric Stuart on color TV. He did an excellent job of analyzing the industry.

Color TV is definitely here to stay. It's purely a matter of time until it takes its rightful place in our economy. Mr. Stuart's story may add impetus to the trend toward the mass production of color TV sets. Most of us certainly hope so.

WILLIAM B. SHEIL

Milwaukee, Wis.

THE SHAPE OF THINGS TO COME

by OTTO ECKSTEIN

■ THE POSTWAR PERIOD has already ended. Today the United States economy is well past the threshold of a new era, as yet unnamed. Throughout the late Forties and during most of the Fifties the United States economy held a position of unquestioned dominance in the free world. But gradually America began to feel the sharp winds of international competition as the economic strength of Western Europe and Japan revived. By 1958 there were many signs that the economy of the postwar world had undergone a marked change. One of the most obvious was the large deficit in the U.S. international balance of payments.

The shape of the economic problems—and opportunities—that lay ahead of our country in the Sixties had begun to emerge as the Fifties ended. During the current decade we may learn how to solve these problems, for we now have the advantage of greater public understanding of them.

Outstanding among these issues are a slow rate of growth, increasing excess productive capacity, more frequent recessions, shrunken profit margins, the impact of automation on employment, rising unemployment, growth of depressed areas and our adverse balance of payments.

Other articles in this issue analyze different aspects of the new economy of the Sixties in greater detail than is possible here. To set the stage, let us try to look forward to 1970 and describe the most prominent features we can now foresee.

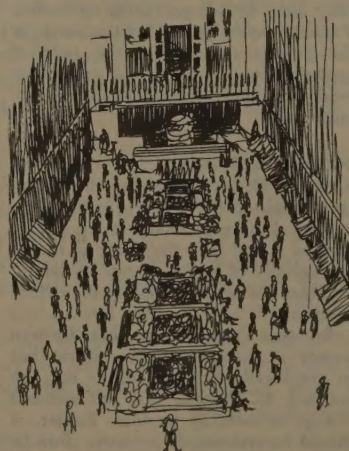
By 1970 the American economy will have grown; output will be larger; more people will be alive, working, earning higher wages, consuming more of most things; government will tax and spend more. Only thermonuclear war, another Great

Depression or reduction of the country to the status of a Soviet satellite could prevent such developments; for this issue of CHALLENGE, we shall stick to more cheerful assumptions.

To say that the statistics will get bigger does not tell us whether jobs will be plentiful, living standards improving rapidly, national goals attained and the value of the dollar preserved. These things depend on our skill in managing our affairs, on our luck and on the state of the world.

Certainly it is a rare occurrence for observers at the beginning of a decade to be able to foresee how things would be by its end. Prophecy in economics may be an interesting pastime, but it is like a game of chess in which wars and other factors have a way of knocking over the pieces.

And yet, we owe it to ourselves to look ahead as best we can, to scan the horizon for emerging troubles and also for signs of cheer. For what we do today, as individuals and as a nation, inevitably starts us off in certain directions rather than in others.



The modern world operates by the faith that the application of reason to the conduct of human affairs is beneficial, and modern reasoning does not rely on closed philosophical systems but on facts and figures, real and projected.

What do we know about the economy of the Sixties, apart from its shaky start? I believe we can identify some important trends that began in the mid-Fifties and are threatening to dominate the economy of the early Sixties. We have a pretty good idea about the future shape of the labor force; we also have a fairly clear notion of where we are, and we are getting an appreciation of the problems that are already visible ahead of us.

That things have not been going quite right in the economy has gradually become clear to observers of all shades of opinion. Everyone is concerned about the signs of weakness—rising unemployment, a slow rate of increase in total output, increasing idle excess capacity, shrunken profit margins and more frequent recessions. And they all relate to one central phenomenon: the goods sector of the economy has been getting into trouble.

Traditionally, this has been America's specialty. We know how to make things. Our technology has been more advanced and the productivity of our workers several times greater than in other countries. Our skilled labor force, our highly mechanized means of production, our technical know-how, our immense market, our abundant resources, and our high levels of income and consumer purchasing power have all served as stimuli to make our economy the world's greatest factory.

Over the last eight years this sec-

tor's prosperity has been eroding. The production of goods, which reached a level of \$208 billion in 1953 (all figures in 1954 prices), was \$222 billion in 1956 and \$234 billion in 1960; this represents an average annual rate of increase of only 1.7 per cent since 1953. In the case of durable goods, where our technological progress and productivity have traditionally been greatest, the increase from 1953 to 1956 was from \$81 billion to \$84 billion, and since then we have not surpassed the 1956 level at all.

Automation permits a given level of output to be produced with less labor per unit. Thus it is not surprising that factory employment has actually fallen in recent years, despite a rising total labor force.

Whereas 17 million out of a total of 50 million in nonfarm employment worked in manufacturing in 1953, by 1960 only 16 million out of 53 million were so engaged. The increase in the number of people working was wholly absorbed by services (including government services) and trade. These typically low-wage, low-productivity industries have acted as a kind of sponge of labor. When workers are scarce, these industries have a large incentive to raise productivity, but with help readily available they have had less need to economize on labor.

Further, the hard core of structural unemployment, which has played a large part in causing more communities to sink to the status of de-

pressed areas, originates in the decline of the goods industries. The fraction of our output devoted to investment in new capital, both to expand production and to reduce costs, has fallen. With manufacturing—a high-wage, high-productivity sector of the economy—in the doldrums and factory payrolls not increasing, retail sales languish and the demand for consumer goods becomes static. Thus, the process feeds on itself.

The reasons for this trend are clear. First and foremost among them has been government policy. Federal purchases of goods and services, after their decline at the end of the Korean war, remained constant and at times even fell; in 1960 they were lower in real terms than at any time since 1951. The credit policies of the Federal Reserve System became progressively more restrictive, keeping down the volume of home building and of other forms of fixed investment. At the same time, taxes were geared to produce large surpluses and kept private purchasing power at levels too low to permit private demand to offset the lack of growth of federal demand.

Second, the purchases of consumers shifted away from goods and toward services. The backlog of demand for durables—a situation created by World War II—had been fulfilled; consumers wanted more of various kinds of services, such as travel, restaurant meals and medical care for an aging population, not to

mention public services such as education. As a result, some reallocation of purchasing power from goods to services was inevitable.

However, this trend was accelerated by government policies which kept consumer purchasing power from expanding at a sufficient rate. Increasing quantities and rising prices of services absorbed more and more purchasing power. At the same time, total real consumer income rose slowly. Consequently, not enough money was left over for the purchase of consumer durables.

Third, our position as a producer of goods for the rest of the world deteriorated. As Western Europe and Japan recovered from the effects of the war, our own goods became relatively more expensive because of inflation. American manufacturers in some lines had to compete with European and Japanese manufacturers eager to sell their products in our markets. These factors caused the prosperity of our manufacturing industries to suffer.

If the trend toward declining employment in manufacturing has been troublesome in recent years, its continuation would be even more serious. In the Sixties, the number of people who will reach working age will be larger than in the Fifties. Under conditions of prosperity, the work force should increase by about 1,200,000 persons a year as compared to 800,000 in the Fifties.

Should the number of jobs in the goods sector fail to increase sub-

THE ECONOMY OF THE SIXTIES: BRIEF QUOTES FROM THE ARTICLES IN THIS ISSUE

OTTO ECKSTEIN evaluating the post-postwar era: "The intellectual climate has changed and concern about economic growth, about meeting our responsibilities abroad and our social problems at home have become part of the conventional wisdom." . . . ROBERT LEKACHMAN on the realm of ideas: "Education, taste and recreation are the key words of the future." . . . DOUGLAS GREENWALD and ALFRED LITWAK on private investment: "There is a good chance that products not yet on the market will account for as much as a third of the total sales of manufacturing companies by 1970." . . . ARTHUR SMITHIES on the role of government: "Many will chide me for raising the ghost of inflation when there are over five million unemployed. But one of our troubles as a nation is that we don't see such ghosts and therefore believe they don't exist." . . . STANLEY S. SURREY on the tax system: "About nine per cent of dividend income goes unreported and about 35 per cent of interest." . . . ELI GINZBERG stating his "first law of manpower: there is always a shortage of good people

in every field." . . . JAMES R. SCHLESINGER on the defense outlook: "It can be predicted with reasonable reliability that, during the 1960s, the relative burden of defense expenditures on the economy will not rise and is likely to fall." . . . KENYON E. POOLE on fiscal and monetary policy: "Before long most of the Western world may suffer from too much, rather than too little, capacity to produce goods and services." . . . GERHARD COLM and PETER WAGNER projecting economic growth: "A sustained rate of growth of 4.5 per cent appears to be a necessary and realistic goal." . . . HENRY G. AUBREY on the prospects for international economic cooperation: "The Organization for Economic Cooperation and Development is a new vessel ready to be filled with as much content as the participants are willing to spare from their jealously guarded store of national prerogatives." . . . ALVIN H. HANSEN on the relation between private enterprise and government: "Once society becomes surfeited with material goods, public needs demand prior consideration."

stantially, four unfortunate reactions will follow: (1) unemployment will increase further; (2) services and trade will absorb some of the influx as teen-agers graduating from high school drift into low-paid retail and service trades in the absence of better-paid opportunities in factories; (3) the proportion of the population in the labor force will become smaller as youngsters stay in school longer, people retire earlier and women who would like to take employment, if opportunities existed, become or remain housewives; and (4) the workweek will shrink as unions push for shorter hours to spread the available work.

Of course, the two latter reactions would represent increased leisure, one of the desirable fruits of economic progress in ordinary times. But the demands on the economy in the coming decades, both at home and abroad, will not be met by increased leisure, and there is certainly no need to create an economic environment which discourages people from working because of a lack of job opportunities.

Hazardous years ahead?

Unfortunately, there is a considerable hazard that the trend toward declining employment in manufacturing will persist for several more years. Even if fiscal and monetary policies become directed more toward expanding the economy, the pull into services has not yet run its course. For one thing, many of the rising government expenditures will be in the nature of services themselves; and for another, the consumption of medical services will continue to increase as the proportion of the population over 65 rises. The rate of formation of new families will continue at moderate levels for another few years before the postwar babies join the ranks of the young marrieds. Business investment, while very difficult to predict and just possibly about to benefit from the vastly expanded research programs of the 1950s, will continue to feel the adverse effect of the idle excess capacity already in existence.

On the other hand, the position of our exports is improving every day as the European boom drives up foreign costs while our own profit expectations and wage increases are

moderated by the slack in our industries. Also, our manufacturers are turning with increasing vigor to the promotion of exports and toward meeting the challenge of imports.

In the longer run, by 1965 or 1966, the outlook for the economy is brighter. By that time the increase in family formation will begin to make itself felt in a greater demand for housing, for appliances, for automobiles, and so on. But there are also some large question marks over the longer period. It is possible that a reduction in international tensions may begin to yield some fruits in the form of lower armaments expenditures. The economy does not need these heavy defense expenditures to sustain its growth, but it would require considerable skill in government economic policy to manage the transition that a lower level of spending on arms would make necessary.

All in all, then, the erosion of prosperity in the crucial goods sector is not likely to be wholly reversed before the mid-Sixties. More likely than not, government policy will need to be geared toward stimulating production rather than keeping demand in check. Of course, if the profit-wage spiral that was so troublesome in the postwar era should begin to operate again, this problem would become immensely more complicated.

For the period past the mid-Sixties, I do not believe it is now possible to venture even a first guess about the state of prosperity that will then prevail.

Since 1958 we have discovered that we are no longer the rich uncle in a world of medics, as our balance of payments has gone into serious deficit and the dollar has begun to look like just another currency instead of the standard of the world. Other nations of the West are enjoying rapid growth and recapturing their historic positions in the complex of world trade; we must now reckon with them to a degree that has hardly been necessary since 1914. We have suffered losses in our market position, and the dollar is no longer considered to have unassailable strength.

The country is now aware of these problems, and if there is a current crisis in our international reserve

position, the measures already taken by us and our allies—or likely to be taken in the near future—will overcome it. Just as the dollar shortage that afflicted the rest of the world vanished in the Fifties, so the dollar glut will disappear as national economies and policies adjust to the new situation.

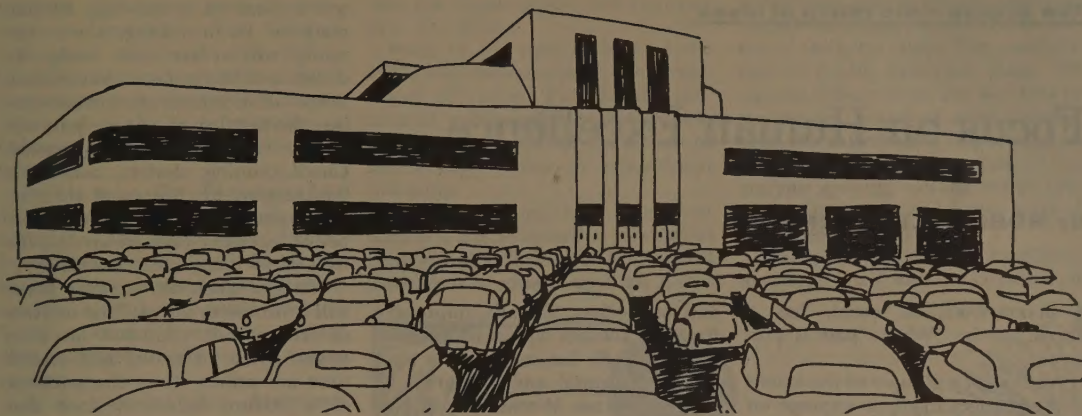
However, we are in the world economy to stay, and on new terms. We must mind our prices and costs like any other good trader. We must maintain confidence in our accounts like a good banker. At times this will complicate our domestic policies, particularly by limiting the means we can use to stimulate the economy. And it will put an important new dimension into price setting and collective bargaining, requiring some moderation of profit and wage objectives.

Unless the President is going to be completely stymied by the Congress over the next four years, the country is about to extend the scope of the welfare state. This will be no revolution comparable to the New Deal; today the role of the federal government in meeting various domestic welfare problems is well established and almost universally accepted. The problems that have already caught the public's and the government's attention, and for which programs have been proposed (and in some cases begun by the previous Administration), include medical care for the aged, aid to education, assistance to depressed areas, reform of the unemployment compensation system and an increase in the minimum wage.

Expanded programs

Various other long-established programs are likely to be expanded, including urban renewal, public works projects, medical research and veterans programs. The total cost of all these programs will be quite substantial, and the recent trend under which the federal government absorbed a declining fraction of GNP is likely to be halted.

It will be simple enough to expand government, but it will be a different matter to do it well. A less penny-pinching, more expenditure-minded posture of the executive branch could easily inflate the costs of agricultural programs, post office



deficits, pork barrel public works and a host of other subsidies. The pressures of local interests on Congress and the President to obtain the benefit of federal programs and projects, which cost the recipients little or nothing, are always immense. All kinds of expenditures benefiting a special few can be enacted in the name of high-minded slogans like resource development, national security and the promotion of commerce and welfare.

What does a quality welfare state mean? In principle, it means that each program be set up and administered according to standards that best promote national objectives rather than special interests. In practice, each field provides temptations for the spoils approach and also opportunities for applying the national point of view.

A rapidly increasing number of programs financed from Washington, but administered and controlled locally, operate under grants-in-aid. These should be re-examined to assure that central government financing does not lead to carelessness and corruption, and that the national purposes are in fact served. In the field of public works there is now too much dependence on local pressure groups that use lobbying tactics to bring projects into being; instead, projects should be chosen according to sound economic principles and only the better ones selected for actual construction.

Depressed areas programs should be more than just a bag of opportunities for areas which know how to take advantage of federal programs, while areas in worse condition are

not helped by the programs. The federal government should assume some leadership in planning; at the least it should survey the possible future viability of each area and, if there is some chance of redevelopment, insist on sensible planning at the local level. If an area has really no potential for recovery and growth, then the federal program should be regarded as a form of relief, and money and food channeled directly to poor people to relieve their plight.

The program involving the most rapidly rising expenditure promises to be the exploration of space. A program costing less than \$100 million annually just a few years ago is approaching the billion mark now and promises to exceed \$2 billion by the end of the decade. Thereafter, one can envisage a further multiplying of outlays. At some point in this decade, preferably early, we will have to figure out *why* we want to get into space. Is it just an attempt to impress other countries? (There are ways of impressing them that are more beneficial to humanity.) Is it a matter of military necessity? (Some experts currently say no.) Or is it simply a heroic act of exploration—like Christopher Columbus sailing into the unknown—the fruits of which are wholly unpredictable? (Perhaps this is the best justification!)

A cynic might say that the economy of the Sixties will be just like that of the late Fifties, only a little more so. We may be busy fighting inflation most of the time, while having just a little of it; recessions will occupy our attention every few

years; we may tolerate an unemployment rate of five to six per cent and explain it away as due to all sorts of intractable structural causes; and we may settle for a rate of growth below our potential one. In this whole process, our longer-term goals may only be incompletely achieved.

I do not believe this view is correct. The intellectual climate has changed, and concern about economic growth, about meeting our responsibilities abroad and our social problems at home have become part of the conventional wisdom. In time, more slowly than many would like, the country will meet them.

Finally, it would be a mistake to exaggerate the importance of strictly economic questions for the Sixties. Whether the world position of the United States vis-à-vis the Communist world continues to deteriorate in the next decade, or whether we shall turn the tide, is only in small measure a question of economics. We certainly have the economic potential now to meet any costs that we choose to incur in the next 10 years to promote the objectives of our foreign policy. Of course, it will be easier if we can meet such costs out of the expansion of output. But we have the resources if we have the will.

This is also true of some of our most acute domestic issues, particularly the problem of equal rights and opportunities for Negroes. Such questions will not be solved by economic growth alone, though a prosperous economic environment will make the task easier. Clearly, we need the will as well as the wealth to solve our problems. ■

Focus on Human Excellence

by **ROBERT LEKACHMAN**

■ SHAKESPEARE, as usual, has a phrase for it: "What's past is prologue."

We can get a glimpse of the extent of the changes likely to impinge on us in the Sixties if we cast our minds back a few years. Then the ideas that helped shape today's economy were new. Just before World War II began, only the boldest of prophets might have sketched the importance in our lives a scant generation later of television, the ranch house and such of its furnishings as deep freezes, air conditioners, synthetic fabrics and thermopane windows. All these products grew from the seed of an idea into the flower of mass produced items.

Again, few could have then predicted our enormous medical triumphs—miracle drugs, open-heart surgery, tranquilizers and the Salk vaccine—which have lengthened life expectancies and diminished the terror of illness. There has been an equally astonishing growth of the leisure industries: golf, fishing and boating, and also Sunday painting, cabinetmaking and amateur orchestras.

As paperback books proliferated, it became impossible to complain that Americans don't read books. While Mickey Spillane has sold his millions of copies, David Riesman and William H. Whyte have found their hundreds of thousands of readers. It is never news that some people like trash all the time. It is news that so many people, given the chance to obtain them, like good books some of the time.

Such changes as these are obvious because they are tangible. They have altered the goods we use, the clothes we wear, the food we eat and the homes we live in. Automatic control devices and ever more intricate machines have transformed our factories

and our offices. Equally impressive has been another type of transformation. Business has created new ways to collect capital and to market its products. Since World War II our society has learned how to channel small savings into major private investments through the mutual funds and the New York Stock Exchange's monthly security purchase program. In the field of selling, the discount house and the suburban shopping center have radically rewritten the old rules of retailing.

It is safe to assume that the alterations in our lives which have marked the last decades have not yet run their course. It may even be, as Leonard Silk argued in his book, *The Research Revolution*, that our large companies have institutionalized invention. The basic scientific research they are now sponsoring may insure them a steady flow of new inventions and devices. The effect on economic growth and economic progress can only be wholesome.

In the 1960s the American house

will become an increasingly efficient machine. Its furnishings almost certainly will reflect both rising incomes and better taste. Automation is only in its infancy. In manufacturing, the number of routine jobs will decline at an increasing speed. Check-scanning devices, automatic bookkeeping machines and electronic computers will diminish the number of repetitive tasks which dull the lives of so many office workers.

Without question, working hours will continue to shrink. The increase of leisure will stimulate an even larger boom in travel and leisure time avocations. It is characteristic of a mature industrial state that fewer and fewer of its citizens must devote their energies to growing food and fiber or converting them into finished goods. More and more of these same citizens live by performing services for each other—services ranging from those of the hairdresser to those of the doctor and the musician.

Trend to services

In the wake of this shift, there is another—a tendency to consume more services and, relatively speaking, fewer physical products. It is not that Americans show any inclination to give up autos and return to horses or bicycles, or to throw away their refrigerators and buy ice-boxes instead. What has happened is that they are putting increasing percentages of their rising incomes into services—travel, medical care, education and the like—rather than into additional commodities.

Thus, one of the really significant economic changes of the 1960s will be a shift in the relative importance of two major kinds of investment: first, investment in the machines which produce goods, and, second, investment in people. The most important kind will be investment in people.

Although both types of investment are necessary, recent history demonstrates that the second is the truly vital one. The case of West Germany shows this clearly. At the end of World War II her industry was largely destroyed, her markets were disrupted and her territory was reduced. Moreover, she had suffered high casualties and her problems were compounded by the influx of



millions of refugees from Russian-occupied territories. But German managerial, financial and technical skill—human knowledge—rebuild Germany into so formidable a competitor that she now represents a balance of payments problem to her friends.

In his grim *On Thermonuclear Warfare*, the physicist Herman Kahn made the same point about human knowledge. He estimated that if our major cities were destroyed in a nuclear conflict, we could still rebuild our economy and approximate 1961 standard of life within a generation.

It is apparent that Americans have collectively taken note of the role of knowledge as a major resource. In the United States the growth industry *par excellence* is education. Already our colleges enroll about a third of the young people in the eligible age group. If present trends continue, by the 1970s we will be educating one-half of the college-age population.

Serious weaknesses

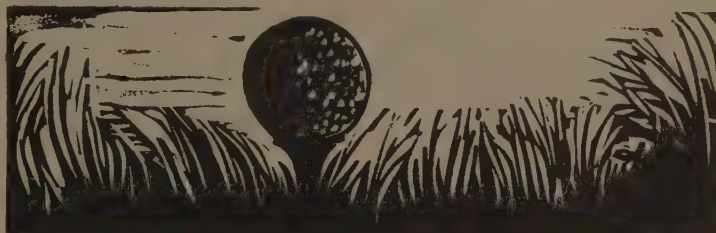
The signs of our concern over education are many. The Conant reports on the high schools and the junior high schools identified serious weaknesses and set off a wave of discussion which still reverberates among concerned parents and Boards of Education scattered across the country. The Rockefeller Fund study of education was significantly titled *The Pursuit of Excellence*. Like the Conant reports it emphasized above all the importance of the quality of education. Advanced-standing classes in high schools, a new emphasis in teacher training on subjects rather than technique, the new competition for places in the better colleges—all these and more have combined to produce a concern for self-improvement which shows every sign of continuing.

Of course, education costs money. This is especially so when it is perceived that better teachers are the prerequisite for better scholars. There is no question that, especially in the precollege years, teaching does not now get its fair share of American talent. The realism of the general public is evidenced by the higher salaries for teachers that have already been achieved. It is certain

that the improvement will continue into the future.

Some of the new notions of the 1960s may cluster around the financing of education. Thus far the concern of public officials and private citizens has produced a number of partial approaches to educational financing.

At the national level, President Kennedy has proposed a substantial program of federal aid. This would assist public schools through direct



aid to construction and teaching salaries, and aid private colleges through an expanded scholarship program. At the state level, Governor Rockefeller has proposed substantial financial aid to college students. In community after community, occasional rebellions aside, citizens have voted the bond issues which support better education and raise their own taxes.

Change in emphasis

Private citizens and corporations have not been inactive. The evidence of the involvement of business is to be seen in the shape of financial contributions to colleges, in building grants, in direct scholarships, in talent searches like the Westinghouse Science Competition and in the Ford-supported Merit Scholarship program. Unions have financed scholarships for the children of their members. Insurance companies have worked out imaginative financial methods to enable parents to support the education of two or more children in college.

Thus, some of the emphasis of investment has changed from the machine to its inventor, from technique as crystallized knowledge to the youngster as a potential embodiment of knowledge. This shift is part of a wider movement. A new concern for human quality has seized Americans in the 1960s. This

is bringing about greater emphasis on health, recreation and the amenities of the great cities. The proliferation of health insurance plans, the current debate about the way best to protect the health of older citizens, even the experiments in group practice by doctors, are aspects of an anxious groping toward better care of human beings and better ways of organizing that care.

The new concern for excellence manifests itself also in criticism of

the low level of mass entertainment, especially television. The large-scale experiment with pay television shortly to begin in Hartford, Conn. may blaze a new trail. It may point to a new way of satisfying some of the tastes of a great many for the less demanding forms of entertainment, while also meeting some of the growing demand for classical music, good theater, informal education and intelligent controversy. Pay television combines imaginative technique and novel marketing in a manner traditionally American.

None of these probable developments, to reiterate an earlier point, implies that Americans have suddenly turned ascetic. The comforts of central heating, automatic transmissions, prepackaged food and air-conditioned offices are much too much an established part of American life for us to discard them. Nor will we neglect investment in machines and factories, the means by which science is translated into technology and technology into a widening stream of consumer goods. However, it appears that we are moving into a stage where the mass consumption of goods will provide the background setting for the personality of the consumer, who will be at the center of attention.

Our old institutions will also change. The fact is that so far we have only imperfectly adjusted our

concepts to the modern business corporation and the modern labor union which so powerfully affect our lives. We struggle against the realization that the giant steel companies and the giant steel union are a great deal more than the independent businessmen and the independent laborers of competitive mythology. The pricing and the bargaining decisions which these large units reach set patterns for other industries and comfort or discomfort us all.

We also struggle against the realization that our economic mythology and our antitrust laws assume a degree of competition that does not exist in industries whose units are large, few—and very much aware of each other. While the 29 electrical equipment manufacturers clearly did engage in illegal activities, nevertheless price leadership, at least, is almost inevitable in an industry dominated by large-scale organizations.

During the 1960s we may clarify our ideas about how the larger corporations behave. From that understanding may flow clearer public policies. Should we break up the largest corporations into smaller units on the assumption that price competition is sensitively related to the number of competitors? Would such a step sacrifice efficiency? If we decide that the big corporation is here to stay, should we not recognize that its decisions are often a matter of public interest? If we do recognize this, can we avoid the establishment of some governmental machinery, whether advisory or compulsory, which can speak for the public interest?

Useful guardian

Conceivably, President Kennedy's new Labor-Management Advisory Board may develop into a useful guardian of the public interest. Certainly the serious concern of businessmen about the relationship of their decisions to the general welfare shows a recognition that the price, location and investment choices of the major corporation are a matter of public interest.

We are indeed nearing the realization that we cannot take for granted management's unqualified right to raise prices. Similarly, we cannot al-

low labor an unqualified right to strike in every circumstance.

With only slight adaptations, the remarks which have been made about corporations apply to unions also. Wage settlements set precedents. They lead to price increases. Restrictive work rules, necessary as they often appear to unions, prevent productivity from increasing as much as it might. In the past, large unions and large business organizations have cooperated, if not tacitly colluded, with each other. Claims for higher wages have been quickly accepted by companies when their markets were buoyant. The increased costs have then been passed on to consumers in the shape of higher prices—which often included



a generous profit margin added to console the corporation.

It is at least possible that we will agree in the 1960s about a fair way to divide the gains of technology. Many questions require settlement. Should wages reflect the productivity of each company? Of each industry? Or only of the whole economy? Should price reductions, rather than wage increases, be the major route by which technical gains are transmitted to consumers? Should we set up a public board to keep one eye on steel and auto prices and the other on wages paid to members of the steel and auto unions?

In a democratic, pluralistic society, public standards and private responsibility are both needed to guide economic power into desirable channels. Fortunately for American democracy, both corporations and unions appear to be taking this responsibility seriously. To cite only

two instances, the AFL-CIO expelled the Teamster's Union for corrupt practices, even though the national organization lost over a million members by following its principles. Again, the United Automobile Workers pioneered when it established a Public Review Board (with Father Hesburgh, President of Notre Dame, as its chairman).

The third party

This board is a testimonial to the UAW's recognition that unionism is not a private affair between a union's leaders and its members. A third party, the public, is also involved. The UAW has loyally supported this board even when it has ruled against union officers and in favor of union members. To the extent that large corporations and large unions themselves evolve standards of public responsibility and adhere to them, the residual task of government will be reduced. It is not plausible to assume that it will be reduced to zero. For corporations must serve the interests of their stockholders and unions those of their members—and in both cases frequently in preference to the general interest.

Let us now summarize these extremely tentative observations about the shape of the 1960s. These speculations have centered about two themes: what the economy of mass consumption will look like and what we seek beyond it. Education, taste and recreation are the key words of the future. These are the keys to the personal culture of the individual that our increasing command over our natural environment has placed in our hands. If we use them as we should, we shall find ourselves spending a larger percentage of our capital resources on the development of the individual, and a smaller percentage on machines and buildings.

This shift of emphasis goes along with a need to face the role of large organizations in our life. We urgently require a clearer definition of the public interest in the activities of the large corporation, the large union and the large governmental bureaucracy. Thus, the ideas that will shape the economy of the 1960s will be those which concern themselves with the quality of our lives and the power of our institutions. ■

The Investment Trend Is Up

by DOUGLAS GREENWALD and ALFRED LITWAK

■ GROWING PRIVATE INVESTMENT will play a vital role in our nation's economic progress in the 1960s. In new and exciting ways, as well as in many familiar ones, U.S. business and industry will be increasing their capital outlays in the decade ahead. In response to the needs and wants of an expanding, mobile population, new industrial capacity will be added at a rapid pace, and outmoded facilities will give way to up-to-date, efficient production processes.

The investment environment, as we move into the 1960s, is in sharp contrast to that of the beginning years of the past decade. As the U.S. economy entered the decade of the 1950s, it was critically pressed for a variety of goods and for additional facilities in virtually every major industry. Production had hardly begun to catch up with the pent-up demand for goods brought about by World War II. The leveling off of demand was further postponed by our entry into the Korean conflict in 1950. Even without this backlog of demand there would have been a need for heavy investment in plant and equipment, since many of the nation's existing production facilities had deteriorated as a result of heavy usage during the war years. The profitability of investment was more or less assured by the rapid price rises that accompanied swollen demand for many products.

Clearly, the current environment is far different. The 1960s began with excess productive capacity in almost every industry. Although world tensions are high, major open conflict is absent. And there is no serious threat of shortages of key commodities.

A recently completed McGraw-Hill survey showed that at the end of 1960 manufacturers were, on the

average, operating at only about three-fourths of their capacity. They would, however, prefer to operate at close to 95 per cent. The iron and steel industry was operating at only 50 per cent of its massive capacity, although producers in this industry have indicated a preference for operating at about 98 per cent. The auto industry, which could probably produce 10 million new cars and trucks in a single year, turned out fewer than eight million last year. Examples of spare capacity are readily available in other industries as well.

Moreover, in contrast to conditions of a decade ago, when prices were increasing substantially, so far in this decade prices of many key commodities have remained remarkably stable. And prices of some—consumer durable goods, for example—actually have declined.

This altered business climate has changed the outlook for investors in many key industries, and it is proving to be a sobering influence on forecasts of business conditions in the 1960s. Nevertheless, there are dynamic forces in the American economy indicating that it will experience considerable economic growth throughout the 1960s. As a result, the nation's gross national product in 1970 may well be half again as large as it was in 1960. This will require a high and rising level

of private investment in the years ahead.

The pressures of an expanding population and a sharply increasing number of new households in the U.S. will definitely make for a rising level of private investment. Population is likely to swell to nearly 215 million by 1970, an increase of almost 20 per cent over 1960. Moreover, the number of new households formed annually will undoubtedly rise sharply as the millions of children born in the early postwar "baby boom" years approach maturity and establish homes of their own. Thus, although production facilities are currently more than ample in many key industries, the growth of our population will gradually erode this margin of excess capacity. The need for additional facilities to produce the items to stock supermarkets and appliance stores will become more pressing.

Population growth, by itself, does not assure expanding investment opportunities. Indeed, unless employment opportunities keep abreast of increases in the number of people seeking jobs, the nation's level of economic well-being will decline steadily. But with the fairly rapid pace of economic growth predicted by most economists for the decade of the 1960s, additions to population can be a source of increasing year-to-



year gains in the nation's economic output.

Moreover, the make-up of our population will undergo a considerable change in the years ahead, with the greatest relative increases in numbers coming in nonproductive age groups—the retired and those considered too young to work. In the nation's key working age group, composed of people between the ages of 30 and 44, there will be a substantial drop in numbers.

This shifting age distribution will have important implications for U.S. investors. Clearly, if living standards are to be maintained with fewer productive workers, the productivity of those on the job will have to rise considerably. Workers will need more and better tools. Thus, investment per worker in manufacturing will have to rise substantially from the present average level of \$18,000 per man. Other industries, too, will have to add to their capital equipment.

One of the most impressive developments in the U.S. in the postwar period has been the movement of population from older urban centers to newly developing cities in the South and West. These population shifts, already well under way, are likely to continue in the years ahead. Substantial new private investment will be required as a result of these shifts, for important changes in the markets for consumer products and for producers' goods accompany any significant moves on the part of the population. And changes in markets require investment in new producing facilities.

Dramatic changes

A look at some of the effects of the sharp increases in population in Florida and California in recent years will illustrate this. Not only has there been a vast increase in investment in real estate and residential buildings in those states, but there have been equally dramatic changes in investment in producing facilities. In 1940, for example, California's steel output capacity was less than one million ingot tons annually. Now that state can produce more than five million tons of steel a year. And other industries in the state have grown similarly in recent years. So it is clear that, even

in industries whose total capacity may appear adequate, changes in the economy continually create the need for new capital outlays.

Moreover, regions of the country that have traditionally lagged behind the nation as a whole in average income per person are gradually loosening their ties to agriculture and shifting to manufacturing activities. This process is causing incomes to rise rapidly. The Southern states, for example, and the Great Plains

sumers in 1950 spent 14.6 per cent of their after-tax income for durable goods.

By the end of the decade, in contrast, there was little incentive for purchasing more durable goods. Consumers owned plenty of refrigerators, washing machines, television sets and cars, and more were readily available. Thus, in 1959, consumer spending for durable goods amounted to only 12.9 per cent of after-tax income. Significantly, al-



region have seen considerable gains in personal incomes in recent years. And in such regions growing incomes will mean wider markets for numerous products. To efficiently serve these newly emerging markets, producers of many major products will be compelled to construct new producing facilities closer to them.

Paralleling the growth in the number of families in the U.S. in the years ahead will be an increase in the number of families who are financially well off. Recent trends suggest that the number of relatively poor families will decline, while the proportion of families with incomes of \$10,000 or more will grow considerably. By 1970 average family income after taxes will have increased by about 25 per cent, an increase substantially greater than that registered during the past decade.

Consumer spending habits, which have changed considerably in recent years, will be further altered in the coming decade. In 1950 consumers were still buying durable goods at a rapid pace in order to make up for the privations of the war years when these goods were not available. Their buying was further stimulated by their fear that another round of scarcities would be brought on by the Korean conflict. As a result, con-

though the after-tax income of consumers had increased by 62 per cent during the decade of the 1950s, their spending for durable goods rose by only 43 per cent. It appeared that the consumer's appetite for durable goods was becoming satiated.

Meanwhile, consumer outlays for services during the Fifties shot up by over 83 per cent. This was due to a number of factors. Since consumers had acquired large quantities of durable goods during the latter 1950s, they were able to devote more of their incomes to such services as travel and education. In addition, the prices of key services such as housing and medical care had risen sharply over the decade. Thus, a greater proportion of a family's income was absorbed in simply providing the basic services essential to a household.

Changing tastes

As we entered the decade of the 1960s, the price of these services seemed to be leveling off somewhat. Consequently, durable goods producers are likely to be able to capture a greater share of the consumer's dollar in the years ahead than they have recently.

Clearly, changing tastes brought about by rising income levels will

affect the consumer's outlays for goods and services in the coming decade. Greater educational achievements will change many consumer preferences—for instance, a tour of Europe's cultural centers may for many people seem preferable to the purchase of a new car. The lure of a private vacation cottage will prove irresistible to many with higher incomes. The growth of this market for second homes will swell the demand for numerous home appliances. Also, as leisure time increases the market for sporting goods will expand greatly. Prospects for continued growth of consumer durable goods industries are thus excellent.

New opportunities

The recent growth of the pleasure boat industry is one example of the new opportunities that develop for durable goods producers as personal incomes rise. The increasing demand for privately owned light aircraft is another. Numerous more modest possibilities arise as growing incomes permit consumers to devote a greater share of their earnings to products other than the basic essentials of life.

Some of the brightest opportunities for new private investment will come about because of industry's growing emphasis on research and development. Spending for industrial research and development doubled over the past five years, rising from \$4.8 billion in 1955 to \$9.6 billion in 1960. Outlays for these purposes are likely to grow steadily; by 1970 they are likely to be about 85 per cent higher than they are now. The result of this research and

development will be a steady flow of new products for both industry and consumers.

A recent McGraw-Hill survey revealed that, on the average, new products will account for about 12 per cent of the sales of manufacturing companies by 1963. And if industry continues to step up its research and development efforts, there is a good chance that products not yet on the market will account for as much as a third of the total sales of manufacturing companies by 1970. New products are especially important to the sales prospects of manufacturers of all types of machinery, the chemicals industry, the metalworking industries and transportation equipment makers. These industries are likely to make heavy investments in facilities to turn out new products that are currently being developed.

Television, stereophonic sound, jet aircraft, plastics, automatic machine tools and electronic computers are today's evidence of yesterday's research and development. Similarly, in tomorrow's world there will be much evidence of today's research.

For example, a new home temperature control system is being devised which, at the flick of a switch, will heat or cool a room by reversing the direction of current flowing through a network of wires imbedded in the walls. High-speed aircraft that can take off and land vertically are within the realm of possibility. So is an earth satellite that will make telephoning to Europe as simple and almost as inexpensive as calling the neighbor down the street. And a

train has been projected that will move along the tracks at astonishing speeds on a cushion of air; this may make the trip from New York to Chicago as swift and as comfortable as it is today by air. Developments such as these will have a powerful impact on U.S. business firms.

The chemicals industry plans to capture a substantial portion of the building materials market by introducing more and better plastics. By 1970, according to some chemicals industry forecasts, plastics will account for 25 to 30 per cent of the building materials market. Similarly, aluminum producers are attempting to capture markets long held by steel. And reinforced or prestressed concrete is coming into widespread use where steel alone was formerly employed.

Pattern of expansion

If these relatively new industries succeed in winning markets from more conventional products, the pattern of industrial expansion clearly would change considerably. The need for new steel producing capacity would decline, while the need for additional outlays for facilities to produce chemicals or aluminum would grow. Relationships among other industries may well change in a similar manner.

However, steel producers are acutely aware of the competition they face from the new products being developed by other industries. They are not likely to sit idly by and watch their markets disappear. To defend and enhance their competitive position, steel producers are stepping up research and development activities. Since 1953 steel producing firms have increased their research and development outlays to a greater extent than any other industry.

Consequently, steelmakers have accumulated an impressive list of new products and cost-cutting processes in recent years. High-strength alloy steels have been developed to provide greater strength with less weight. The weight of the metal in a conventional tin can has been reduced by about a third. Such improvements clearly make for a more attractive product. At the same time, the introduction of new processes—for instance, oxygen injection in the

FORECAST OF THE COMPUTER MARKET

INVESTMENT IN COMPUTERS promises to be heavy during the Sixties. These electronic data-processing devices can already run chemical plants, oil refineries and electric power stations automatically. The machines have enormous capabilities to transform masses of raw data into meaningful information on which management can base decisions.

Some 4,500 computer systems were operating or installed in the United States last January and about 6,000 were on order, according to an estimate by John Diebold & Associates, leading authorities on the use of computers. They predict that by the end of 1965 the total number of computer systems in operation will be in the neighborhood of 19,000, and that these systems will be worth between \$8 billion and \$10 billion. Another authority estimates that computers, together with electronic industrial process controls, will account for 20 per cent of all durable goods sold 10 years from now, thus making up a sizable share of all new spending for plant and equipment.

open hearth furnace and direct reduction of iron ores—are enabling the industry to increase productivity tremendously and hence remain competitive on a price basis as well as on a product basis.

New products are leaving an equally heavy imprint on other industries. Take the auto industry, for instance. Although the auto producers had substantial excess capacity, they had to invest heavily in new facilities to produce compact cars when the market for this new product began to expand rapidly. In the years ahead, the practical development of revolutionary auto designs now on drawing boards could, in the same way, require a new round of heavy investment in auto producing facilities. Perfection of an auto powered by solar energy, or by electricity produced by a fuel cell, is within the realm of possibility. The far-reaching investment consequences of such a development are obvious.

Bring new vigor

Clearly, then, research and development are bringing new vigor to industries whose prospects for growth and profits in the years ahead would be dim indeed without the benefit of new products and processes. And they are creating opportunities for investment in brand new industries too.

Nucleonics, a postwar baby, is just beginning its growth. As research uncovers new uses for radioactive isotopes and other products of nuclear science, activity in this industry will accelerate. Automation of offices and factories will create a need for new forms of office machinery and for new instruments and controls that can handle complex production processes. And investments by firms producing these products are likely to grow substantially over the decade.

In addition to investing in additional capacity, U.S. business firms will devote a considerable portion of their capital outlays to modernizing obsolete producing facilities. Virtually every industry has a substantial backlog of relatively inefficient producing capacity. These outmoded facilities will have to be brought up to date if firms are to operate profitably in the years ahead.

A 1958 McGraw-Hill survey revealed that almost half the U.S. producing facilities then in operation had been installed before World War II.

Though this study estimated that the cost of bringing this obsolete capacity up to date would be about \$95 billion, there are obvious incentives for going ahead with this vast modernization job. Many of today's machine tools are 50 per cent more productive than early postwar models. And production processes in virtually every industry have grown far more efficient.

Recent investment patterns suggest that manufacturing firms are making great progress in their efforts to rid themselves of inefficient plant and equipment. In recent years, manufacturers have devoted about two-thirds of their annual investment in new plant and equipment to modernization programs. Only one-third of their capital outlay has gone for additional producing capacity.

As mentioned previously, steel companies have made outstanding progress in cutting production costs through modernization. The produc-



tivity of open hearth furnaces is said to have risen by 20 to 100 per cent because of oxygen injection. Firms in many industries have sharply reduced their inventory requirements through the use of electronic computers and scientific control systems. Business firms are just beginning the enormous task of modernizing their clerical operations, an undertaking made possible by the use of computers and other recently introduced office machines.

The need for efficient producing facilities will become even more pressing as restrictions on international trade diminish, thus permitting the development of wider markets for consumer and producers' goods. Since the end of World War II, European producers have re-equipped and expanded their plants at an extremely rapid rate. They are prepared to compete with their U.S. counterparts on the basis of quality and price anywhere in the world. To meet this challenge, U.S. firms will have to employ the most modern plant and equipment and the best skilled labor available. Bringing obsolete plant and equipment up to date is thus likely to continue to be an important reason for making new capital outlays in the 1960s.

However, the creation of new industrial facilities is only part of the task of modernization facing the nation. Our congested and decaying cities are clearly in need of extensive rehabilitation. Urban renewal will require considerable private investment by builders and financial institutions as well as public investment. Lending institutions are already investigating urban renewal as a new outlet for their growing investment funds, and their interest in such ventures is likely to increase. Undoubtedly, the demand for attractive cities will grow stronger in the years ahead. As it does, the opportunities for investment in urban rebuilding will grow with it. For the foreseeable future, this vast market will provide a steady demand for new private investment.

So it is clear that private investment will continue to play a vital role in the growth of the economy in the 1960s. Investment in facilities to produce new products, investment in more efficient facilities, investment in facilities to serve shifting markets and tastes—these are the general forms private investment will assume in the years ahead. Research and development, rising incomes, a growing, mobile population and vigorous business competition are the dynamic forces that will call for a high and rising volume of investment in new producing facilities throughout the decade.

The business firm that turns these forces to its advantage can look forward to a prosperous decade. ■

Balance Wheel of PROGRESS

by ARTHUR SMITHIES

■ SINCE ECONOMICS is to a great extent the handmaiden of politics, government undoubtedly will have much to say about the shape of the American economy of the 1960s. There are, however, no overriding economic forces today that will determine the function of government in economic affairs. Our economy is flexible enough to operate successfully with considerably more or considerably less government intervention than we now have. Whether we have more or less is largely a matter of political choice—though this choice may be dictated by circumstances beyond our control, such as Soviet moves.

My general expectation is that the present balance of political forces within the United States will continue for the rest of the decade. The present Administration (or one very like it) will work with a Congress somewhat more conservative than the Administration. Together they will reflect fairly accurately the temper of the public. This forecast assumes that the cold war will continue at its present degree of intensity and that we shall live with the Russian version of "peaceful coexistence" rather than the Chinese.

The events of the last two months indicate that the new Administration has neither the intention nor the inclination to make a sharp break with the past. (An Eisenhower adviser rather smugly remarked, "You got your man and we are getting our measures.") Thus, the composition of the "mixed" American economy seems likely to change little.

I do not mean to imply, however, that the role of government in American life will remain static. There will be more intervention in some economic sectors and possibly less in others. But, on balance, it seems

likely that the trend toward more intervention will continue. This statement can be made with some confidence in view of the fact that the Eisenhower Administration could do little to reverse the trend, though dedicated to the proposition that such a reversal was needed. A political democracy prefers the consequences of its own visible acts to the workings of the "invisible hand," that, according to Adam Smith, produces the general good from the strivings of individuals for economic advantage.

Before discussing the role of government that seems most likely, let us briefly examine a number of less likely possibilities.

First, there seems little chance that the hopes of the so-called conservatives will be realized. These conservatives can be more accurately described as "reversionists" since their objective is to revert to the economic arrangements of the Twenties or even earlier. History does not abound with instances of a democratic society reverting to an earlier state; and I am convinced that the United States will not do so. The reversionists may, however, help prevent further shifts to the left and also divide the forces attempting to move appreciably to the right.

The second possibility is that 1964 will be another 1936—an election year bringing with it a sharp shift to the political and economic left. This could happen if we were in a deep recession. Then massive unemployment would create an insistent demand for a thoroughgoing recovery program based on government expenditures of the New Deal variety, but undertaken on a much larger scale. Particular industries, such as the railroads, might well be taken over by public corporations.

But such a turn to the left does not seem likely. The unemployment of today arises from the failure of job opportunities to expand rapidly enough. The record so far does not suggest that this type of unemployment has drastic political consequences. Moreover, an upward trend in employment is easier to accelerate than a downward trend is to reverse. It should be within the government's competence to reduce present unemployment levels in the next few years—as will be seen later.

The outbreak of a large-scale nuclear war is a third possibility. Provided the "balance of terror" persists, the starting of such a conflict would be an act of such monumental insanity that one cannot contemplate its being deliberately undertaken. As for nuclear war breaking out by accident, there is reason to hope that precautions against this happening will be taken by the United States and Russia—which will be the only important nuclear powers during the Sixties. If such a war does occur, the consequences for the economy are incalculable and the part to be played by government even more so.

The fourth eventuality is general disarmament during the next decade. This is so unlikely that I exclude it as a real possibility. However, a word or two concerning the possible economic consequences of general disarmament may be in order. The outcome from the point of view of government economic activity would depend on the readjustment policies adopted. If the cessation of military expenditures were promptly accompanied by a combination of drastic tax reduction and, perhaps, moderate increases in existing government welfare and foreign aid programs, the adjustment could take place fairly smoothly, with no pronounced change in the economic role of government.

The fifth possibility is an intensification of the cold war. This possibility cannot be dismissed as lightly as disarmament. Nevertheless, we resolutely avoid thinking about what will happen as Soviet economic power increases. Peaceful coexistence may come to mean continuing aggression by the Communist bloc in international trade. This could involve attempts to attract the weaker non-Communist countries to the bloc

by the use of bilateral trading agreements. It could also mean disruption of world markets through systematic dumping. The general response should undoubtedly be to keep levels of demand high in the major free world countries and to keep their markets open to the exports of the weaker countries.

Far-reaching measures

The governments of the United States and other major countries may, however, be forced to take other far-reaching measures. They may have to outbid the Communist bloc for products of weaker non-Communist countries and negotiate agreements to regulate the prices of such commodities. Also they may have to resort to the extensive use of direct import controls to prevent the Communist bloc from dumping their own goods or those they purchased elsewhere. (Already, as in the case of Egyptian cotton, the bloc has bought from underdeveloped countries more primary products than it could consume, and then dumped them.) Such international action would tend to make controls on our own economy necessary.

The sixth possibility is that a limited war will erupt. A new conflict as extensive as that in Korea would inevitably call for increased government controls. In appraising such possibilities, however, the circumstances surrounding the defense effort at the time of the Korean war should be recalled. Only to a minor extent was that effort undertaken to meet the needs of the war; the bulk of it was for rearmament under a revised defense policy. Since then, defense expenditures have never been reduced to anything like the pre-Korean level.

I now return to my general prognosis that there will be no abrupt changes in national policy. Let us consider some of the major economic problems, calling for government action, that have become apparent.

First, there is the question of accelerating the rate of growth of the economy. We are exhorted to return to the historic rate of some three per cent a year and then to move up to four or five per cent. If this is really our goal, much will have to be done. For instance, we would have to:

- Increase the rate of capital for-

mation—the provision of capital goods, such as machines, that produce wealth.

- Encourage business to modernize its equipment.

- Stimulate research and development.

- Keep industry operating at full capacity.

- Provide for full employment of labor, perhaps with a longer workweek than we now have.

A comprehensive program on these lines could mean: (1) an overhaul of the tax system to favor savers and investors; (2) government programs for research in nondefense as well as defense industry; and (3) repeal of premium overtime laws. Most of these measures run strongly counter to prevailing political trends.

The contribution to growth that wins widespread political acceptance is the maintenance of full employment, and the techniques for achieving it are well known. But, judging by experience, we have not yet learned how to achieve continued full employment without inflation, particularly of the wage-price variety. (This type of inflation is produced when wage increases are not matched by increases of productivity and are paid for by employers through price increases. These price increases cause more demands for higher wages, which are satisfied in the same way.)

The control of wage-price inflation is one of the most urgent unsolved problems we face. And the need to control it has become particularly acute since, in the face of rigorous international competition, the United States can hardly afford rising prices at this time. The only remedy we seem prepared to use for

this type of inflation is to allow considerable unemployment and to tolerate excess capacity in industry. Besides being socially undesirable, this particular remedy may become politically intolerable.

One school of thought rejects this remedy outright. Its adherents argue that full employment and full use of industrial capacity would stimulate productivity greatly, thereby permitting wages to rise more rapidly without price increases. This point of view may be correct, it may be wishful thinking or it may mask indifference to inflation. Unfortunately, governments cannot experiment without taking the consequences of their experiments.

Wage disputes

The public almost certainly wants assurance that full employment will not be accompanied by inflation. To achieve this, government intervention in important wage disputes—with respect both to prices and wages—would, in my opinion, be necessary. This is not the place to make detailed suggestions. It is enough to say that we must first discard the idea that a wage dispute is merely a contest between employers and labor. The country as a whole has a vital interest in important wage disputes and only the President himself can adequately assert that interest.

Whether the problem will be solved in this way is open to some doubt. In the past, Presidents have been reluctant to become involved in wage-price questions. They have intervened only during national emergencies—and not always with fortunate results.

If nothing is done and inflation occurs, one of the most serious con-



sequences would be increased pressure for protection from foreign competition. And if significant departures were made from our liberal trading policy, the forces of protection would gather further strength. Then we might return to a policy of high protection, with incalculable, distressing consequences on our foreign policy.

Another possibility is that the government will impose direct wage and price controls. This could happen if it failed to check wage-price inflation by selective action—i.e., intervention in important disputes.

Many will chide me for raising the ghost of inflation when there are over five million unemployed. But one of our troubles as a nation is that we don't see such ghosts and therefore believe they do not exist.

A second urgent problem is that of "structural unemployment," unemployment resulting from the decline of industries or from automation in thriving industries. Sometimes too sharp a distinction is drawn between structural and general unemployment. For there can be no cure, other than make-work projects, for structural unemployment if workers cannot move to places where jobs are available. They naturally prefer to stay where they are if the prospect elsewhere is also unemployment.

During World War II we saw how rapidly unemployment that had been considered structural could be reduced in response to a high general demand for labor. But that experience also showed the difficulty of attempting to cure structural unemployment by exclusive reliance on general measures. It demonstrated that not merely full employment, but overemployment (an excess demand for labor), may be needed to induce labor to move. Such overemployment is likely to produce an unacceptable degree of inflation.

Consequently, to facilitate mobility of labor and to ease its burdens on individuals, the government may have to intervene. The measures called for are training or retraining, expanded employment services and movement allowances. Accomplished workers in distressed areas could be given a one-way railroad ticket to any region of the United States where there are good employment

opportunities. Such measures are likely to be more beneficial to the unemployed and less costly to the government than subsidized industrial expansion in the distressed areas themselves.

A third problem is that of agriculture. Its solution calls for less government intervention rather than more. Some economists argue that the United States is rich enough to spend billions every year producing surpluses that cannot meet the test of the market. But our agricultural policy is a matter of international as well as national concern. U.S. productivity in agriculture is one of the most valuable resources we have to contribute to economic development throughout the world.

Food for peace

This resource is being extensively but inefficiently used in the foreign aid program. Its effectiveness could be greatly increased if the pattern of U.S. production responded to world needs rather than to domestic agricultural policy. There is danger that the Food For Peace Program may perpetuate the present inefficient pattern of production in the U.S. By disposing of surpluses, it seems to make more surpluses politically tolerable. Agricultural production in the United States should increase for the indefinite future. But the economic and political objectives of our foreign policy would be better served if foreign aid funds were used to buy agricultural commodities in the world market and the surplus disposal program were eliminated.

The fourth problem area is that of social welfare. All levels of government are involved in it—in education, health, social security, recreation, conservation of natural resources and the reconstruction of cities. There can be little doubt that over the decade the trend will be for expenditures on all these services to rise. It is certain that absolute amounts spent will increase. Probably they will absorb a greater percentage of national income. Increasing population, increasing longevity and increasing urbanization are all creating situations which, sooner or later, will find expression in increasing demand for public services. These facilities either cannot be provided by private industry or, as in

the case of roads, are needed to make possible the enjoyment of private industry's products.

As these demands for public services increase, the fiscal relations between the various levels of government will demand increasing attention. Many of the services can be most effectively provided by state and local governments. The question of whether those governments should raise the additional revenue needed or should depend on federal grants-in-aid will come sharply into focus. Or perhaps the issue will be decided by default in favor of federal grants which would further weaken state and local governments.

Fifth, and finally, the impact of foreign economic policy on the domestic economy must be taken into account. That policy calls for an expanded foreign aid program. But our balance of payments at the present is in a precarious position. Therefore, a larger foreign aid program must be accompanied by increased exports, decreased imports or a decreased outflow of capital.

If domestic inflation can be kept under control, there is no reason why American industry should not become increasingly able to compete with foreign producers. As a consequence, our balance of payments position would improve. Otherwise, an expanded foreign aid program may require the introduction of government controls. These might take the form of tying aid to American production, limiting the export of private capital or restricting imports through tariffs or quotas.

One aspect of foreign aid has received insufficient attention. If the President's proclaimed objective of increasing foreign aid is to be carried out, the greatest shortage is likely to be not of dollars or foreign exchange, but of the skilled manpower needed to administer a program covering as many as 80 countries. Ordinary methods of government recruitment are likely to be inadequate. The solution may require entirely new arrangements for cooperation between government and private institutions.

I conclude this discussion with the uneasy feeling that my assumption that things will remain much as they are now during the Sixties may be disproved by the onrush of events. ■

STANLEY S. SURREY

Assistant Secretary of the Treasury



The Role of the Tax System

Q *Mr. Surrey, as the Assistant Secretary of the Treasury in charge of tax policy, what, in your opinion, are the principal objectives of any tax system?*

A The main purpose of any tax system is, of course, to raise enough revenue to meet the obligations of the government. But since the aggregate sums involved are so large, the functioning of the tax system obviously affects the performance of the entire economy. In a democratic society the tax system is not only obligated to facilitate the growth of the whole economy, but also to insure that both the system and its administration are fair.

Q *To do this job, doesn't a nation's tax system have to be constantly re-evaluated to see that it is performing the task it is supposed to?*

A Certainly. The tax message which President Kennedy sent to Congress in mid-April is the first result of such a re-evaluation.

Q *Would you say that the provisions of the President's tax message were not only designed to meet new conditions but also to correct some basic inequities?*

A This is true. But what you describe as inequities have in many situations only become such as a result of changing conditions. As our society develops, and as business conditions change, many provisions that originally were not significant turn into serious special preferences and inequities.

Q *Would this refer to the four per cent credit on dividend income and the exclusion of the first \$50 of dividend income from taxation?*

A Yes. Our experience with these provisions since they were passed in 1954 clearly does not justify their retention. I would add that in this case many thought from the start that these provisions were unwise.

Q *In other words, you don't agree with the argument that the taxation of corporate profits and the further taxation of these profits when they are distributed to stockholders as dividend income constitutes double taxation.*

A Whether one agrees or disagrees with the argument about double taxation, it can be demonstrated that this

approach is not the proper one for getting at the problem—assuming that one exists. The provisions of the 1954 law only result in special treatment for recipients of dividend income who are concentrated in the upper income brackets. They remove a far greater proportion of the double tax burden—if one exists—for the upper bracket recipient than they do for the lower bracket recipient. Neither the four per cent credit nor the \$50 exclusion is a proper solution to any of our problems and both should, therefore, be repealed.

Q *Are there any provisions in the President's tax message which could be described as specifically designed to meet new conditions in our economy?*

A A significant change recommended by the President to meet new conditions is the tax incentive for businesses which invest in new plant and equipment. An incentive of this nature would contribute immeasurably to our rate of economic growth which the President has indicated on many occasions is not now satisfactory. This incentive would take the form of a direct credit on the tax bill for a certain percentage of a firm's investment in new plant and equipment. Although this would involve an estimated annual revenue loss of \$1.7 billion to the Treasury, it will make a significant contribution to stepping up our economic growth rate which, in the long run, will bring in more tax revenue.

Q *Why do you feel that the investment credit approach is preferable to the depreciation approach which has been advocated by many business groups?*

A By a depreciation approach I gather you mean some form of accelerated depreciation or at least a greater amount of depreciation in the first year.

Q *Exactly. The kind of approach the government used during the Korean war to stimulate certain kinds of investment.*

A One reason is that we do not think it is particularly helpful to confuse tax incentives with depreciation. If the two are intertwined it won't be long before we won't be able to determine how much is tax incentive and how much is depreciation.

Q *This is undoubtedly true. But from the business-*

man's point of view, which method gives him a greater incentive to invest in new plant and equipment, the investment credit approach or a stepped-up rate of depreciation?

A There is no doubt that the investment credit is a greater stimulus since, as far as the investor is concerned, accelerated depreciation is merely a loan. The greater depreciation in the early years resulting in a lower tax liability is reflected in a heavier tax liability in later years when the depreciation rate is reduced. The investment credit, on the other hand, is an outright tax reduction; it does not have to be repaid in later years.

Q Which method results in a greater revenue loss to the government?

A The only way to approach the question is to assume that the revenue loss should be the same whichever method is chosen. The important point is, then, which method will achieve the Administration's purpose of stimulating the growth of the entire economy and provide the greater incentive, given the same amount of revenue loss. On this basis, the investment credit wins hands down.

Effect of the investment credit

Q Would it be fair to say that one of the reasons the Administration proposed the investment credit at this time is the fact that we are in a recession?

A The investment credit could certainly be described as a step toward alleviating the recession. But it is an approach that would be just as pertinent if we were at full employment—in fact, it will bear its fullest fruits when we are at full employment. We must increase our growth rate if we are to provide the necessary jobs for the millions of workers who will enter the labor force during the 1960s. It will be up to the economy of the Sixties to provide the employment opportunities for the millions of war babies born in the early 1940s who are now approaching working age.

Q It would be fair, then, to say that the investment credit is designed to aid both the current recession and the future growth of the economy?

A Yes, that is true. But it presupposes that we are now on the way to recovery, so that there will be sufficient demand to absorb the increased output of the new and modernized plants that will result from the measure.

Q You mentioned previously that this would cost the government approximately \$1.7 billion in the first year. Isn't this a serious revenue loss for the budget which is already unbalanced?

A The revenue loss will be offset by the other recommendations in the President's message. Thus, at least one-third of the revenue loss will be recouped through the proposal calling for the withholding of taxes on interest and dividends at the source. It is estimated that this will bring in at least \$600 million in taxes on income which has not been reported up till now.

Q In effect, the Administration feels that its recent

efforts to educate recipients of dividend and interest income to their tax obligations is a failure.

A Although I am sorry to say so, that is correct. We have found that despite the extensive efforts that our corporations, banks and stock exchanges have made to educate recipients of dividends and interest to their tax obligations, these recipients, for one reason or another, have not stepped up their degree of compliance. This, of course, is not the fault of the institutions paying the interest and dividends, and the Treasury Department certainly appreciates their efforts to inform the public.

Q How much of this type of income would you estimate goes unreported?

A According to our best estimates, about nine per cent of dividend income goes unreported and about 35 per cent of interest. The total is nearly \$4 billion. This results in a significant revenue loss to the government, and we see no way of getting at this considerable amount of undercompliance except through some sort of automatic machinery that reaches the average taxpayer.

Q I believe the Administration is seeking a straight withholding rate of 20 per cent on all interest and dividends. This still won't get at the entire tax liabilities of those in the upper income brackets whose tax obligations are far more than 20 per cent of their income.

A This is true. But we feel that if we have this automatic machinery for getting at those in the lower brackets, we can concentrate on other methods of enforcement to insure compliance from those in the upper brackets.

Q You might say that this is another step toward automation in the Internal Revenue since a large part of this could probably be accomplished through a more rigid enforcement of existing statutes by putting on more manpower.

A The withholding system would avoid an inordinate expenditure of time and money which could be more sensibly devoted to other matters. Even if this expenditure were made it probably would not achieve any significant reduction in the dividend and interest gap.

Obligations to society

Q Do you feel that there is any merit to the arguments of some businessmen that in effect the government is transferring this burden of insuring compliance to the payers of interest and dividends through the withholding system? Many businessmen feel that this is an additional chore which will be both time consuming and costly, and that, furthermore, they are doing the government's work.

A Any expenses that a private institution incurs in complying with such a statute are deductible from its federal income tax. As for the time involved, we must all realize that in a democratic system we all have certain obligations to society as a whole. A withholding system is certainly a sensible application of the resources of our society to meet a problem which confronts

STANLEY S. SURREY

it. If certain groups of taxpayers, through ignorance, carelessness or deliberate evasion, are not paying their proper share of taxes, an unfair burden is placed on the great majority of taxpayers who are meeting their obligations to the government. Moreover, the withholding system proposed does not place any significant burden on the payers of dividends and interest.

Q *Did the Treasury Department try to ascertain the effects the proposed system would have on the various institutions which would be obliged to comply with the new regulations?*

A Before recommending a withholding system on interest and dividends, the Treasury Department discussed the effects of such a system at great length with institutions that might be affected, including corporations, commercial and savings banks, investment companies and the stock exchanges. We understand, for example, from a number of banks that the actual burden is slight compared to existing bookkeeping obligations of banks in general.

Little hardship involved

Q *After talking to these people, then, the Administration was convinced that any additional burdens the new system would impose would be slight. This, of course, does not mean that the institutions affected are also convinced.*

A This may be true. However, many of the prior doubts resulted from a lack of understanding as to the actual mechanics of the proposal. We feel that many of the doubters were convinced by our explanations of the system's simplicity. Thus, many appreciated that the burden would not be significant once they realized that they would not have to distribute withholding slips to both the recipients and the government as in the case of deductions on salaries and wages.

Q *What about the argument that this system would impose a hardship on small income recipients of dividends who have very few tax obligations? Although they would get this money back at the end of the year, they really need it to meet their day-to-day living expenses.*

A Any withholding system is bound to involve a certain amount of overwithholding. Since we feel that this hardship may be even greater to recipients of interest and dividend income, the Treasury Department is recommending that refunds be paid during the year to certain low income recipients of interest and dividends—primarily those who would not be subject to taxes in any event since their taxable incomes are too low.

Q *Would it be fair to say that the proposed withholding system for interest and dividends is less complex and would impose far fewer burdens on the average business than the withholding system on salaries and wages which has been in effect for almost 20 years?*

A Yes. The Administration has tried to make it as sim-

ple as possible. The payer of interest or dividends will merely deduct a straight 20 per cent of the total of interest or dividends paid to recipients as a group. There is no reporting on an individual basis. The payer does not have to be concerned about the recipient's tax bracket or the number of dependents he might have. Payers of salaries and wages, on the other hand, must consider each recipient on a separate basis.

Q *Do you see any other areas, in addition to dividends and interest, where there is a large amount of taxable income going unreported?*

A There is some underreporting in the case of salaries and wages in areas not covered by the withholding system. There is also underreporting in the case of certain professional income. This problem also exists to some extent in small proprietorships and in the farm sector. It is difficult to have precise information on the extent of noncompliance in any particular area. However, as government turns to the use of automation, and the tax collection process is able to acquire statistical information more rapidly, these areas of noncompliance will become clearer, and government will be able to direct its energies to systematically reducing the degree of noncompliance throughout the entire economy.

Q *How do you get at situations of underreporting in cases where a man does a job and receives cash in return? Isn't this an impossible task?*

A Expensive and time consuming maybe, but not impossible. A good auditor can, through various devices, reconstruct the income an individual would have to have to maintain his standard of living over a given period of years. If his net worth and manner of living are inconsistent with his income as reported on his tax return, there has obviously been some underreporting. Once this has been established, a good auditor can pretty closely estimate how much tax this individual owes to the government.

Q *This, of course, would require a higher percentage of audits than has been the case in the past.*

A Yes, it would. The Commissioner of Internal Revenue has already asked Congress for more funds to hire additional personnel to do the job.

Strengthening confidence in the tax system

Q *This would mean even higher administrative expenses than we now have?*

A Only in the very beginning. Eventually this higher percentage of tax audits would bring in far more revenue than it would require for the additional personnel. Furthermore, it would strengthen the confidence of the average taxpayer in the equity of the tax system. People do not object to paying their fair share of the costs of government if they feel that everyone else is doing the same. As I said before, one of the first requirements of a nation's tax system is its fairness to all of the taxpayers involved.

Q *Would you say that the proposal for a withholding*

of taxes on dividends and interest was, in part, an attempt to make the tax system a fairer one?

A Definitely. Once a taxpayer has the idea that it is easier for some kinds of income to get away with not paying taxes than his kind of income, he is far more inclined to evade his proper share of taxes.

Q *What you are saying, then, is that the way the tax laws are written and enforced has a direct bearing on the desire of individual taxpayers to comply.*

A That is certainly true. The government not only has the job of constantly reviewing the tax laws so that they are consistent with changing conditions in the economy, it also has an educational job to demonstrate to the citizens that these laws are equitable and that it is in their interest to comply. Of course, in order to convince people that the laws are fair, they must really be so. Otherwise you are wasting your time.

Q *Is there any kind of program to get this message across to the public?*

A I think that the language of President Kennedy's tax message calling attention to the need for tax reform is certainly an attempt to get this message across to the public.

Q *However, there is no program within the Treasury Department specifically designed to do this job.*

A Not as such. However most public statements by Treasury officials on the tax system certainly emphasize the fact that over-all we have one of the fairest tax systems in the world and that it is in the interest of each citizen to comply with all its provisions.

Designed to meet changing conditions

Q *You mentioned earlier that several items in the President's tax message—the investment credit among others—were designed to meet changing conditions in the economy. Can you envisage other changes during, say, the next five years that would necessitate further adjustments in the tax structure?*

A It is, of course, very difficult to predict the problems that may arise in the years ahead. I have no doubt, though, that the Administration five years or so hence will be requesting changes in the tax structure to meet conditions which are unforeseeable right now. There is, however, another outstanding example, in addition to the investment credit, in the President's tax message which is a response to changing conditions.

Q *I imagine you are referring to the proposal connected with the treatment of foreign income.*

A Yes. Not many years ago it was in the national interest to encourage investment in Western Europe and Japan. As a consequence, the tax incentives afforded U.S. companies to invest in those areas were considered as consistent with our over-all policies. Conditions have changed so rapidly in the past few years, however, that it is no longer in the national interest to encourage such investment through tax devices. Here I am not only referring to our balance of payments deficit, but also to the need for encouraging investment by American companies in the less developed areas of Africa, Asia and Latin America. What I am saying here, of course, is that

what was in the national interest in the Fifties is not in that interest any longer.

Q *Don't you face a very practical problem in trying to update the tax system to meet the needs of the times? The Administration's ability to get its reform program passed by Congress may very well depend on how the proposed law is formulated. If enough interest groups are affected, they could combine to defeat any measure you might put forth.*

A I would hope that Congress judges each particular subject on its individual merits so we wouldn't run into the problem of simply adding up opponents. In any case, the recent tax message was a carefully thought out program which provides enough additional revenue to compensate for the losses which might be incurred by new provisions.

Q *Do you think that another such program will be presented to Congress next year?*

A The President has already indicated that next year the Administration would present to Congress a program of tax reform which would involve the elimination of many special preferences coupled with a re-examination of the entire rate structure. I suppose that you could call this a package since the two are so intertwined. It has often been pointed out that since the rates are so high and the system so complex, many businessmen spend more time determining the tax consequences of a particular action than on the move itself. This could eventually become a drag on the entire economy since it distorts the judgments and energies of our citizens. It is this situation along with the desire to increase the fairness of the tax system which next year's program will be designed to ameliorate.

Competing for the tax dollar

Q *Although, as you indicated before, it is difficult to foresee many of the problems that will confront us in the future, I think you will agree that there are some areas in which the future difficulties are already becoming visible.*

A I'm sure this is true.

Q *One example that comes to mind is the competition among various levels of government for the tax dollar. Since the taxes we pay to local governments are deductible from federal taxes, won't the federal government suffer a serious revenue loss as these taxes grow bigger and bigger?*

A Perhaps this may be a problem, though it does not seem so now. The revenue-raising power of the federal system is very great, and one issue of the future will be to what extent need it be used to assess the states and localities in meeting their problems. The relationship of the federal, state and local tax structures is a problem that deserves constant attention.

Q *Is there any existing machinery for the coordination of the various tax structures?*

A Yes. There is an advisory commission on intergovernmental relations which considers matters of this nature.

STANLEY S. SURREY

The commission is composed of officials of the federal government, including the Secretary of the Treasury, and officials of state and local governments, as well as members of Congress. This commission is systematically considering the problems of intergovernmental relations with special reference to problems arising in the field of taxation. I think the work of this commission will be quite helpful in bringing about better coordination between the federal system and state and local systems, and a more coordinated way of dealing with the difficult problems in this area.

Q *While we are discussing the various sources from which tax monies might be raised, what is the justification for so-called luxury and excise taxes. Isn't the government sitting in judgment as to what constitutes a luxury?*

A There is some connotation of that, but it is a situation which exists in nearly every country in the world. Whether citizens who drink or smoke should pay heavier taxes than those who don't is a problem that society must decide. Government policy is merely a reflection of that decision. In most modern societies this form of taxation is considered appropriate probably not for any particular reasons of morality but as a proper means of raising revenues. The United States relies much less on such taxes than, say, the United Kingdom. Alcohol and tobacco taxes are fairer than many other excises in the sense that the majority of the people probably use both.

Q *This criteria could not, however, be applied to the so-called luxury taxes on items such as furs and jewelry which were instituted during World War II and have not been repealed because of the revenue problem.*

A I would have to agree that the narrower the base of the tax the more one must consider whether it has a place in our tax structure. Certainly the tax on furs and jewelry would fall into this area.

Q *In other words, you are saying that it is fair to tax something that is everyone's luxury but less fair to tax a luxury consumed by a few people.*

A I think that luxury may be a poor term here. It's hard to put cigarettes, alcohol and gasoline in the luxury class. These are commodities used by most of the population. I think that they are appropriate revenue sources for the government and will probably be taxed for a long time to come.

Taxes as a stimulant to growth

Q *Do you see any possibility of the repeal of the wartime excise taxes which affect only a small segment of the public?*

A It is possible that they might be repealed or reduced if the government finds that the revenue picture so warrants.

Q *I would like to return to the problem of how the tax system can be used to stimulate the growth of the economy of the 1960s. If the provisions in the current tax message—assuming it passes—do not get the economy*

moving at a more rapid rate, what other tax measures do you envisage that might possibly accomplish this end?

A If our economy grows at a rate of say three per cent over the next decade there will be a very considerable increase in tax revenues. Consequently, a budget surplus could well develop that could become a drag on our economy.

Q *What you are saying is that by 1970, although it seems hard to believe, our problem will be one of surplus rather than the problem of constantly looking for new sources of revenue.*

A Yes, it is a strong possibility. The revenue-raising power of our tax system at full employment is very strong and many consider it too strong. The consequent budget surplus must then be examined to see if its existence impedes our growth. There are, however, offsetting factors. We cannot accurately predict what our defense and space expenditures are likely to be by 1970. Another unknown factor is the extent to which the resources of the federal government will be needed to aid state and local governments with their problems at the end of the decade. Another problem is how our tax system can be made to operate more responsively to changes in our economy so that the periods of ups and downs can be flattened somewhat.

Q *Although it looks rather remote now, do you feel that in the event of a lessening of international tensions, disarmament could pose some serious problems of readjustment for the American economy? Do you think that we've been too dependent on it during the 1950s?*

A Although I am not an expert on this subject, I am aware of several studies currently under way regarding the effects on the economy of a decrease in defense expenditures. My understanding is that these studies show that the economy can readily adjust to such changes.

Q *Would the tax system be used to facilitate this adjustment, say, in directing the allocation of resources into different sectors of the economy?*

A I think it is too early to tell what part the tax system would have in such a readjustment. Although it may be used to some degree, I doubt that it would be used to direct the allocation of resources. In the United States, this is a matter we have largely left to the market place.

Q *What you mean, of course, is that while the tax system is used to stimulate the economy as a whole by measures such as the investment credit in the President's tax message, it is not generally used to encourage citizens to purchase one kind of product in preference to another.*

A Yes, that is correct.

Q *Would you say that the philosophy of this Administration is to go along with this method within the foreseeable circumstances?*

A That certainly appears to me to be the position of this Administration.

Q *Thank you, Mr. Surrey.*

CHALLENGE NOTES

Sidelights on the passing economic scene

SIGN OF THE TIMES—The present campaign to "Buy American" is spreading throughout the country. *Printers' Ink* has reported that "in Chicago, Cleveland and Detroit, written on store fronts, alley walls and on sidewalks—a rash of signs have appeared lately, reading 'Volkswagen Go Home.'"

► A very compact slogan!

• • •

THE MARCH OF TIME—In 1911 horse-drawn trucks in New York City averaged 11 miles an hour, according to the New York State Commission on Governmental Operations of the City



of New York. Today their motor-driven successors speed along at six m.p.h.

► At this rate transportation in New York will come to a complete halt in 2021 A.D.

• • •

A NEW NOTE—New York's Carnegie Hall was recently the scene of a financial—not an artistic—get-together. For the first time an annual meeting of a corporation was conducted within those melody-haunted walls. The performance of the American Radiator and Standard Sanitary Corporation was reported to its stockholders. Joseph A. Grazier, the company's president, announced a substantial drop in sales for the first quarter of 1961 compared to the same period last year.

► Economy off key?

• • •

TELLER'S-EYE VIEW—Banking reports on the less conventional traffic of the drive-in branch of The First National Bank of Columbus, Miss. Among the patrons were a farmer on a tractor, another driving a team of mules, a horseman, two children on tricycles who wanted change and a bicyclist.

► No anticyclical movement yet apparent?

• • •

WORDSMANSHIP—The Burroughs Corp. is advertising its new information

processing system as "dedicated to obsolescing obsolescence"—a slogan that seeks to cash in on the recent furor over planned obsolescence.

► Why not really be original and plan unplanned planning?

• • •

SEASONAL NOTE—"The advent of spring normally brings with it not only sunshine, flowers and romance, but also a rise in the price of gasoline."—*The Henry George News*.

► In the spring a young man's fancy lightly turns into a business indicator.

• • •

COLD WAR FINANCE—Recently we received an unsigned anti-Communist form letter asking us to support a bill that would prevent Communists "from taking any tax exemptions except household."

► To encourage them to stay home?

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NORTHWEST PASSAGE, NEW STYLE—*Advertising Age* recently pointed out that the readers of a Midwestern newspaper were not confused by an airlines ad advising them to "Fly Northwest to Florida."

► The slogan is mightier than the compass.

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SPACE FINANCE—Today anything about space has a certain news value, so we report the following 19th-century item. In 1886 a 107½-pound meteorite fell on Christopher Shandy's farm in Johnson County, Ark. Mr. Shandy sold the visitant from outer space for \$35. Some four years later, Herr Albert Mayer-Gunthof, an Austrian industrialist, purchased it for about \$40,000.

► Better record than IBM's stock!

• • •

STREET FIGHT—The house organ of a large oil company describes a "war souvenir" hanging in the New York headquarters of the American Gas Association. The souvenir—a large electric bulb mounted on an oak plaque—was



donated by a gas utility company. The inscription reads: "Enemy light bulb captured during the 'Battle of the Fuels,' Lower Oliver Avenue, Pittsburgh, November 17, 1958. Replaced by gas streetlight."

► A "fuelish" war!

• • •

TREND SPOTTING—This rocking chair thing is spreading. The firm that made the President's famous piece of furniture has taken on help to meet a leap in demand. Another straw in the wind is that Edward G. Stockdale, the new Ambassador to Ireland, brought his wife's great-great-grandmother's rocking chair with him to Dublin.

► That old rocking chair stock must be sky-rock-eting!

• • •

SHREDDED SECRETS—*Modern Office Procedures* reports a new paper shredder that destroys confidential records right in the office. Up to 100



sheets of loose paper, cards and tickets can be stacked in an automatic feeder. Paper clips and pins do not damage the cutter. The refuse bin holds up to seven wastebaskets of paper.

► Is there a Spanish-language model for C. I. A.?

• • •

THE CUSTOMER STRIKES BACK—"Most salesmen talk too much. They rely too heavily on personal acquaintance. They don't really try to find out a customer's problems. And many of them don't follow through, once the order book is closed." According to *Business Week*, these are the findings of a merchandise director of A. O. Smith Corp., who polled several of the company's procurement supervisors to find out what they thought of salesmen.

► Get that foot out of your mouth, boy, and into the door!

• • •

THE ART OF RELAXATION—"The reason mankind is around today may well be that early man was not a tasty meal for the wild animals that lived in his day. . . . Today's wild animals, such as lions, sniff at sleeping humans and then go away without attacking them."—*Science News Letter*.

► Some people are sound sleepers!

MACHINES vs. MEN?

by **ELI GINZBERG**

■ ON A RECENT VISIT to California I saw what may be "the shape of things to come" in the way manpower will be used during the decade ahead. Surpluses of semiskilled workers have developed; at the same time the competition for scientists and technicians has become intense. Consequently, many workers holding down full-time jobs are trying to raise their level of skill by attending college. A senior official of U.C.L.A. told me that the campus is busier at 9 p.m. than at 9 a.m.

The obvious truth is that machines are taking over semiskilled jobs. In the new self-service parking centers, for example, attendants are unnecessary. And the batteries of automatic vending machines burgeoning on every hand dispense with the services of clerks. Other efforts to economize on the use of service personnel are widely evident.

It seems, to this economist at least, that other nationwide trends in the use of manpower are most apparent in California. A tremendous governmental effort in education ensures that an ever higher proportion of young people will complete at least junior college before entering the job market. The continuing rapid mechanization of agriculture is further shrinking the opportunities for year-round employment in farming. The increasing number of married women holding down paying jobs is adding substantially to family incomes and to the demand for goods and services. Finally, the federal government is playing an important role in the expansion and contraction of employment, primarily through its military procurement policies.

These appear at the moment to be the important trends, but caution must be used in prognostication. Past experience shows that the more

general the manpower forecast, the more likely it is that it will be proved false.

Toward the end of World War II almost all the leading economists warned about a prospective unemployment level of eight million or more—a level never even approached, much less reached. Just prior to the outbreak of the Korean war a government agency warned about the coming surplus of engineers; but during the next several years professional engineering organizations were predicting serious *shortages* in the supply of engineers. These calculations, in turn, soon proved to have been considerably off the mark.

Similarly, the ominous predictions made by many organizations about a serious crisis on the teacher front have been proven false. The elementary and secondary schools certainly do not have all of the qualified teachers they need, but the grievous gap between supply and demand predicted by prophets of doom has simply failed to develop.

Manpower estimates

It is easy to be wrong in making manpower estimates, for the market has a way of righting itself, at least partially, when it faces major imbalances. If engineers are in short supply, technicians may be trained in their place. If there is a shortage of qualified teachers, educators re-appraise optimum class size, stress self study, use "teacher economizing" devices such as TV and try to draw former teachers back into employment.

Furthermore, if the market by itself is unable to re-establish an effective balance between supply and demand, government action is likely. In the face of shortages of trained personnel, education and training can be expanded. In the

face of labor surpluses people can be encouraged to retire earlier (the objective of amendments to the Social Security Act before Congress as this is written) or the school leaving age can be raised. Perhaps most important, the federal government can force the pace of the economy by general or specific legislation aimed to increase the demand for labor.

There is no longer any need for a modern industrialized society such as ours to remain passive in the face of serious underutilization of its manpower resources. To say that this is not likely to happen again in our society may be the only manpower forecast that has a good chance of being right.

Now that the inherent limitations to manpower forecasting have been pointed out, what can be set down as useful reference points for assessing the manpower situation of the 1960s?

In the absence of large-scale war, demographic trends are among the more stable factors in any manpower forecast. Most of the people entering the labor market at a given time were born about two decades earlier. The year after the men came home from the war—1946—the birth rate rose; thus, in 1964, the number of young people to turn 18 will jump in a single year from about 2.7 to about 3.3 million. (In 1951, which was 18 years after the low point in the birth rate during the Great Depression, less than two million young persons reached 18.)

Throughout the current decade, the proportion of 18-year-olds entering the labor market will decline as more of them go to college, and more young women marry and start families. In spite of these factors, however, not much relief from the pressure for new jobs can be expected. From now on the number of young people to turn 18 will increase each year. The full impact of the larger number of job seekers will probably be felt in 1966 or 1967, perhaps before.

The order of change between the 1950s and the 1960s can be summarized thus: in the early 1950s fewer youngsters turned 18 because of the drop in the birth rate two decades earlier; at the same time the demand for young people was up because the Korean war produced an expansion

of the armed services and industry. In the middle 1960s, by contrast, the number of 18-year-olds will be substantially larger because of the growth in the birth rate two decades earlier; moreover, barring a radical change in the international scene, the manpower requirements of the armed services will be reduced—partly because of their increasing reliance on a career force.

Veritable revolution

There are many other facets of the potential supply which are more cloudy. Still, reasonable estimates concerning their impact can be made. The shortage of workers during World War II and the shortage of young people in the late 1940s and 1950s made it possible for increasing numbers of married women to find jobs outside the home, thereby bringing about what the National Manpower Council has referred to in *Womanpower* (1957) as a veritable revolution in the employment of women.

The forces that helped to bring about this revolution do not appear to have spent themselves, and it is, therefore, reasonable to forecast that the 1960s will see a substantial increase in the number of women in the labor force. And the available statistics undoubtedly understate the size of this potential source of labor. For many women who would like to work do not search for jobs because they believe, usually correctly, that opportunities are not available. Several years ago I estimated conservatively in my book, *Human Resources: The Wealth of A Nation*, that there were five million women not currently employed who would work if jobs were available.

Surplus farm labor has long been a major source of the long-term increase in the nonfarm labor force. There is every reason to anticipate that this situation will persist. There are now probably between one and two million persons on farms who are there only in the absence of a strong industrial demand for labor.

The essence of the farm problem is a manpower surplus—too many people, many of them underemployed, producing too much. And the amount of surplus labor on the farm can only climb in the years immediately ahead because of the

coming increase in 18-year-olds and accelerated mechanization. If American agriculture as a whole is not to become a "depressed area," it is essential that many people now living on farms be relocated in cities. Or, alternatively—as has begun to happen in certain areas in the South, the Middle West and the Far West—new plants must be located in farming areas so that those who continue to live on farms will have a chance for industrial employment.

There are still other important sources of future workers: the more than five million who are currently unemployed and those who will be displaced from their present jobs as a result of technological changes. What are the possibilities that these people will find new jobs in the years ahead?

The immediate outlook is not particularly encouraging. Recovery from each of the last several recessions left the country with a higher level of unemployment than did the previous recovery. Therefore, unless a very



strong and sustained upturn follows the present recession, the numbers of the "chronically unemployed" may be both absolutely and relatively greater than during the previous disappointing periods of expansion.

While the conventional interpretation of this disturbing trend has been primarily in terms of the premature exhaustion of the forces of economic expansion, there is another facet of the problem that warrants attention. Rapid technological changes are now taking place in heavy industry—steel, automobiles, rubber, paper, glass, among others—with the consequence that more and more semiskilled production jobs are being permanently eliminated. The need for a strong recovery is, therefore, that much more urgent.

A sustained period of economic expansion would undoubtedly result in some increased employment in these sectors. But most of the expansion would undoubtedly occur in other sectors—particularly in the service trades. It does not follow, however, that men displaced from heavy industry will find it easy or even feasible to find a place in the expanding service sector. There are such crucial matters as location, occupational ties, trade union affiliations and skill qualifications.

Above all, it is very difficult for a skilled machine worker who formerly earned over \$3 an hour to settle for \$1.50 or less in a service trade. He is likely to hold out for a long time hoping to regain a place in his old industry. By the time he accepts the fact that he must make a radical change he may be in such a weakened competitive position—due to age, lack of resources to finance retraining and years of unemployment—that he will not be able to find another job. A man is not quickly convinced that his luck has run out. He who builds his life on hope and pride cannot easily sacrifice both.

There is every reason to question the assumptions of those who are currently optimistic about the long-run outlook for employment. Employers are eager to speed the introduction and use of automatic machinery. Their willingness to pay a high money price for union sanction of their plans to automate is an indication of the importance they attach to reducing labor costs by eliminating large groups of workers.

Released from employment

To the extent that they succeed, the years immediately ahead will see large numbers of older persons released from employment long before they are ready for retirement. Younger persons will also find themselves out of work. They will have little option but to search for a new occupation, frequently in a new locality. Older workers will shift more slowly, and when they do convince themselves that it is necessary to change their occupation or residence, they will encounter greater difficulties in finding work.

There is another aspect to the impact of the new technology on the future supply of labor. Many new

automatic machines are being introduced into the clerical and service trades which, in recent decades, have met most of their labor needs by employing women. The high turnover rates for women are making it relatively easy for these sectors to install major labor-saving devices without precipitating large-scale unemployment. There may be no overt technological displacement of labor in clerical and service occupations, but the long-run opportunities for employment may either fail to expand or actually decline.

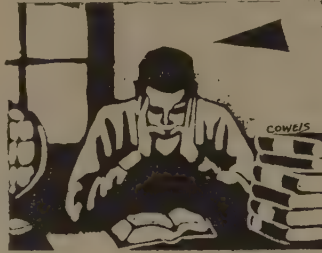
Are there any forces on the horizon which will tend to reduce the number of potential job seekers? Reference was made earlier to the fact that education and training is taking longer than it used to. This trend is likely to continue and, to the extent that it does, will operate to relieve or at least postpone some of the pressure for jobs.

Better off working

But there is another aspect to the trend toward lengthening the period of education that warrants comment. There are probably several million young people above the age of 15 currently in school who are there not out of choice but through coercion; they are not there because the school is making a significant contribution to their acquisition of knowledge and skill, but because our society has failed to work out any effective alternative. Probably at least one out of every four young persons above the age of 15 currently in high school would be better off working. But because of law and custom, jobs are not available for them. They must remain in school even though they will learn little if anything from doing so. A sound society should try to contribute more to the development of those adolescents who have little aptitude for or interest in bookish matters, but who are eager for the work experience they must have if they are to develop properly. We need not worry, as many educators do, that leaving school early necessarily implies the end of formal education for such young people. With increasing maturity, many would undoubtedly learn to appreciate the value of additional education and would return to school part time, or even full

time, to increase their knowledge and training.

Retirement may speed the flow of persons out of the labor force. All of the evidence suggests that the trend toward earlier retirement which set in many years ago has persisted throughout the 1950s and will continue in the 1960s. Those who are now in their late forties and



early fifties are likely to see retirement as a much more attractive prospect than did their more work-oriented parents.

There is one factor that may operate in the opposite direction and keep more older persons at work. The longevity of women is increasing. The average woman lives seven years longer than the average man, and since she marries a man three years older than herself she faces 10 years of widowhood. In recent years an increasing proportion of women in the 55 to 65 age group have been active in the labor force. This trend may continue because, among other reasons, many of these women live alone and have no satisfactory way of filling their days unless they work.

Few Americans realize that during the past decade the United States government deliberately expanded the labor force by encouraging Mexican farm laborers to come into the U.S. on short-term contracts. Recently the number of *braceros* has averaged about 450,000 annually.

Currently efforts are being made to unionize domestic farm laborers on the West Coast. In addition, government officials and leaders of various social welfare organizations are becoming increasingly concerned with the fact that the influx of *braceros* prevents a rise in the wages of domestic migrants and an improvement in their working conditions. As a result, we may see a new public policy that will, in the years

ahead, cause a substantial decline in the annual inflow of foreign migrant labor. But for a rapidly growing labor force currently numbering 70 million, not much relief from the pressure for jobs can be expected from tightening this one spigot.

At the height of the public concern with the shortage of scientists and engineers in the early 1950s, I formulated what I hoped might one day come to be recognized as Ginzberg's first law of manpower: *there is always a shortage of good people in every field*. I see every likelihood that this law will be operating in the coming decade.

No matter how many people will be looking for work in the 1960s, there will be a considerable—and possibly even an increasing—proportion of jobs that will be filled by people who are not sufficiently educated, trained or experienced to cope with them. The more our society seeks to speed up scientific research and technological changes—for military and other reasons—the more it is likely to experience a shortage of first-rate people. And two, or even four or eight second-rate people are no substitute for the man capable of making a true breakthrough on which further progress will depend.

Nor will the demand for able people be limited to scientists and engineers. The problems that the United States has been facing in international affairs during the past decade give no promise of disappearing or even becoming smaller. And as the steel strike of 1959 and the federal conviction of the executives of leading electric companies in 1960 have indicated, the management of corporate enterprise could be strengthened to the advantage of both its stockholders and the public.

Talented individuals

The inevitable shortage of good people increases the need for employers in every domain—business, government, academic life—to consider more carefully how best to utilize talented individuals. For unless talented individuals are used well, they will be unable to develop their full potentialities, and the needs of our society for competence and skill will not be met.

This means there is an urgent need to insure that young scholars

need not trade their spare hours for additional income. Young executives and administrators should be given enough responsibility and authority to show what they can do. Government and industry should, when making their grants for research and development, stop fooling themselves that money alone can buy what they want; instead they should realize that the proper course of action is to do their best to back the right men and to hope that on balance their good guesses will outweigh their bad ones.

Discriminatory barriers

There is also urgent need on human and political, as well as economic, grounds to seek the speedy removal of all discriminatory barriers in the labor market. Women, Negroes, Spanish-speaking Americans, the physically handicapped and older persons meet varying degrees of discrimination. This waste of manpower adds up to a very large total. There has been a running argument among economists for a century as to whether market behavior can be interpreted solely in terms of a logic of pecuniary calculation. As far as today's manpower policies and practices are concerned, such a logic certainly does not rule.

For reasons cited earlier, one can do no more than sketch the broad outlines of the manpower picture of the 1960s. The shape of the future will largely depend on the cumulative results of the legion of choices which will be made from day to day and from year to year.

Thus, there is no possibility of now forecasting the exact manpower situation of the end of the decade. For the levels of employment and unemployment that will later develop will depend primarily on economic developments and political decisions that will occur between now and then. At this time it is possible, however, to identify some of the major determinants that will shape the outcome.

The past decade witnessed a considerable growth of the total economy, but this expansion was not sufficient to make full use of all who sought jobs. In the coming decade we face a more difficult challenge, for the numbers seeking work will be markedly greater. It is overly

optimistic to expect the private economy, by itself, to expand at a rate that will provide all the jobs that are needed.

The impact of research and technology will not produce a sufficient expansion of employment unless many new products and new industries can be profitably launched. For research and development—on which the economy's future so largely depends—eliminate existing jobs at the same time that they create new ones.

The prospects of growth in the private sector, then, are substantial but may well be below the desired level. In that case, what are the options open to government?

First, there are a range of *policies*—tax revision, assistance to small business, guarantees for foreign investments, among others—that might accelerate the economy. But effective policies will not be easy to design or carry through, for each has a negative as well as a positive result on employment.

Second, there are a series of *direct actions* that government might take. It could create a modernized Civilian

Conservation Corps and a large Peace Corps; it could expand public works programs. Above all it could make vast additions to the foreign aid program, additions focused on the export of goods. But each of these actions would have a limited impact—and together they might well precipitate a prolonged and severe inflation.

What remains? Simply this: government must recognize its continuing obligation to contribute to the creation and maintenance of a level of employment that will make effective use of the total manpower resources of our society. No one has the answers, at this moment, as to how this can be done. But it can only be accomplished if the federal government commits itself to accomplish the basic objectives of the Employment Act of 1946: these are to foster and promote "conditions under which there will be afforded useful employment opportunities . . . for those able, willing and seeking work, and to promote maximum employment, production and purchasing power." ■

The Sixties — the cost of national security

Will The Defense Burden Be Lighter?

by JAMES R. SCHLESINGER

■ PUBLIC DISCUSSION of the relationship between the defense budget and the national economy generally involves questions which are based on the assumption that the economy is highly inflexible.

One such question, with which we are perennially confronted, is: How much defense spending can our economy support? In the hands of the gloomier prophets, this question is merely the prelude to the conclusion that national bankruptcy stares us in the face.

Another question, which is in a

sense the opposite of the first, inquires whether a catastrophic depression will engulf the nation if defense expenditures were to cease. In other words, can we afford *not* to have large defense expenditures?

A third and somewhat more sophisticated question raises the issue of whether vested interests built into military spending will freeze our national strategies and policies and prevent their readjustment, if the opportunity should arise, for example, of a rapprochement with the Soviets. As we shall see later, there

is something more to this question than to the first two. Nevertheless, it also is based on the exaggeration of certain tendencies in our society and the ignoring of all offsetting forces, thus providing the kind of frightening specter with which the public likes to alarm itself.

Economic burden

If we are ready to employ our resources properly, the American economy is capable of supporting all foreseeable defense requirements. True, the defense establishment constitutes something of an economic burden. But before we can make a proper assessment of the probable weight of this burden during the Sixties, there are three realities regarding defense spending which should be made clear.

To begin with, no one can state with certainty how large the defense establishment should be. The virtually absolute security that the United States had enjoyed in the past has disappeared in the age of the intercontinental ballistic missile. It has become necessary to learn to tolerate some degree of insecurity. It is possible to reduce that insecurity by additional defense expenditures which simultaneously may give a rival pause before making an aggressive move and will provide the United States with the capability of taking countermeasures if the need should arise.

The question is: How much of our resources do we wish to devote to reducing insecurity? Or, to put it another way: How much additional insecurity are we willing to tolerate in order to use our resources for nonstrategic purposes? Thus, defense expenditures will depend upon the defense posture of the United States. The smaller these expenditures are, the smaller can be our effective commitments, and the likelier it is that the West will retreat in the so-called "grey" areas—lands where its interests are not immediately and vitally involved.

Second, projections of defense spending are impossible without knowledge of the strategic content of future situations. The more aggressive the Soviets and the Chinese Communists are, the greater our expenditures are likely to be. Coping with brush-fire wars will require

some expansion of the defense establishment.

Third, almost all Americans will agree that the maintenance of national security is paramount and that, consequently, "ordinary" economic considerations are secondary. We should be willing to make readjustments in the defense budget when it appears to be necessary without being unduly concerned about the impact that such adjustments would have upon the economy at large.

In spite of the difficulty of making projections of defense spending, it seems clear that it can be predicted with reasonable reliability that, during the 1960s, the relative burden of defense expenditures on the economy *will not rise and is likely to fall*. Such a development would continue the trend since the Korean war. Since 1953 defense spending has fallen from 12 per cent to eight per cent of gross national product. Despite considerable discussion of the need for an increase in defense spending during the last Presidential election, the Kennedy Administration has already indicated that the changes it will make in the Eisenhower Administration's defense plans are quite modest.

Small increase

For the fiscal year 1962 the Kennedy Administration has increased Eisenhower's estimates by some \$650 million to \$43.8 billion—a rise of 1.56 per cent. This relatively small increase may be taken to represent the defense posture that the Kennedy Administration would like America to maintain. Increased expenditures are planned for Polaris submarines and Minuteman missiles, but such increases will be partially offset by a reduction of spending on Titan missile squadrons, on the B-70 bomber, the Nike-Zeus antimissile missile, and the development of a nuclear plane.

These spending plans are substantially different from what might have been predicted during the last Presidential election. At that time Sen. Kennedy expressed sympathy with the views of Gen. Maxwell Taylor who had called for defense expenditures running to some \$55 billion. During the early days of the new Administration much emphasis

was placed on the necessity of strengthening our conventional forces intended to deal with brush-fire wars. But words are cheap, and the actual changes ordered by the Administration have been quite limited and are symbolized by the requested increase in manpower of some 13,000 men for the 1962 fiscal year.

Military officers have been disappointed by the meager additions being provided to our limited warfare forces, although their disappointment has been hidden by the Administration's clampdown on public statements by members of the military establishment. (It is somewhat ironical today to recall Gen. Taylor's bitter indictment of the Eisenhower Administration's defense policies on such matters as manpower limits, refusal to spend more on Nike-Zeus, ignoring of the service chiefs and the planning of military strategy by civilian "amateurs.")

It may well be that the small changes proposed by President Kennedy are not a good indication of his long-term plans for the military establishment. But even if the expenditures on conventional armaments and forces for limited warfare were to increase very substantially (rising perhaps to Gen. Taylor's figure of \$55 billion), or even if the United States were to become involved in a brush-fire war, there is still reason to doubt that the relative burden of the defense establishment will increase during the 1960s.

A shift in the Kennedy Administration's policies might mean an increase in defense spending of \$5 billion or \$6 billion per annum in the two or three years immediately ahead. Such a development would increase the share of GNP devoted to defense. However, one must recognize that this would be a short-term development occurring at the beginning of the decade.

GNP will rise

By 1970, if nuclear war does not break out, it can reasonably be expected that the GNP will probably rise to some \$800 billion. Unless, therefore, some very substantial shift in our defense posture should occur during the Sixties, a defense budget of up to \$65 billion could be maintained without increasing the pro-

portion of our resources devoted to defense. At present it seems unlikely that so high a level of expenditures will be reached. Consequently, it can be predicted that the burden of the defense establishment will gradually fall.

Expense-saving innovations

This projection is supported by the knowledge that advances in weapon technology in the last five years have been inherently expense-saving innovations. For a nation which has the capacity to produce long-range missiles, the latter provides, in the long run, a much more economical form of deterrence than manned bombers. At present, to strike effectively at an enemy with bombers, their antiaircraft defenses must be saturated. But there is no defense against a missile attack. Bombers are expensive in terms of manpower; the maintenance costs of

By the end of the 1960s the economy will probably be large enough to support, without undue strain, defense expenditures equal to approximately three times the present level. Defense expenditures seem likely to climb by a very much smaller amount. Consequently, it seems likely that concern over the capacity of our economy to support an adequate defense establishment, and over the slow growth rate of the economy, has been overdone. Although the economic burden of the defense establishment could rise during the early years of the 1960s, the longer-run outlook is for a diminution in that burden and, consequently, a possible reduction of tax rates.

An additional cause of concern arising from the existence of a large military establishment is generated by the fear that the latter, in conjunction with its supplying industries, will acquire an undue influ-

the military-industrial complex. The potential for the disastrous rise of misplaced power exists and will persist.

"We must never let the weight of this combination endanger our liberties or democratic processes."

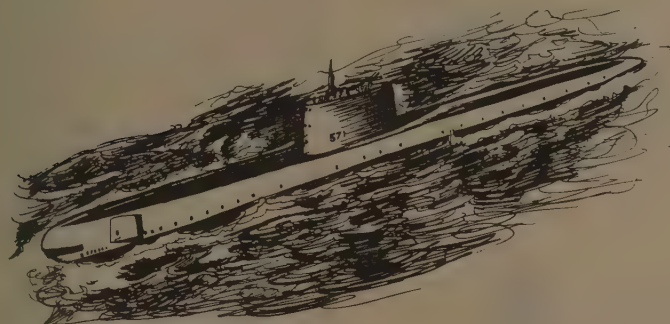
Was Mr. Eisenhower correct in expressing so grim a view of the implications of the growth of the military establishment? In part, despite his evident sincerity, the concern is overdone. The warning may be viewed as one of several ritualistic expressions of the American fear of the threat to individuals arising from the growth of organization and of "vested interests"—a reflection of our Jeffersonian heritage.

Traditional credo

The contribution of conservatives to public discussion tends toward a reiteration of the individualistic postulates of the traditional theory of democracy; expressions of devotion to the familiar creed overshadow the desire to analyze the newer realities. Society is, however, what it is, and our society is, in reality, one in which political decisions are a resultant of the conflicting pressures of organized pressure groups. Whatever its relation to the traditional credo, our society has exhibited its true genius in holding in line the parochial demands of several organized interests.

"The military-industrial complex" may add one other pressure group to the variety of ethnic, economic and regional pressures coming to bear on Washington, but there is no reason to believe that it cannot be controlled, especially in light of the unmilitary character of the American outlook. The American economy and the American society have been able to cope with new forms of organization in the past. All political prophecies that have suggested that any one group could achieve dominance have turned out to be vast exaggerations. The "military-industrial complex" which might obtain control of our foreign and domestic policies, according to Mr. Eisenhower, represents a modern variant of Charles Beard's "merchants of death"—and may be viewed as a similar form of Jeffersonian hyperbole.

There is no intention to suggest



missiles, on the other hand, are quite modest, although their development costs are high.

Once an effective missile system is designed, the outlays required to maintain a deterrent force of incalculable striking power are quite moderate. For this reason it can be predicted that no drastic increases in defense outlays (that is, no more than 25 per cent) are likely to take place in the next decade. Research and development expenditures are likely to increase, but the absorptive capacity of the defense establishment for useful expenditures on research and development is quite limited. Perhaps the most likely increases will occur in defense-associated activities such as space exploration.

ence over the nation's policies. President Eisenhower in his "Farewell Address" was quite sharp in expressing his warning about this problem.

"This conjunction of an immense military establishment and a large arms industry is new in the American experience. The total influence—economic, political, even spiritual—is felt in every city, every statehouse, every office of the federal government. We recognize the imperative need for this development, yet we must not fail to comprehend its grave implications. Our toil, resources and livelihood are all involved; so is the very structure of our society.

"In the counsels of government, we must guard against the acquisition of unwarranted influence, whether sought or unsought, by

that the military-industrial complex does not create new problems. The problem is a different one because the defense establishment, broadly construed, so patently overlaps both industry and government. Procurement officers, for example, moving over into the aircraft industry, will shed their uniforms and do approximately the same job that they performed when on the government's payroll. The links between the defense establishment and, say, the aircraft industry are extraordinarily close. One need only look at the proportion of total production that Lockheed, or United, or Douglas or Martin, for example, sell to the government to understand the closeness of the relationship.

Reduced efficiency?

It is clear that the suppliers may persuade the government to purchase an excessive amount of aircraft (which may mean reduced efficiency of defense expenditures), but this is a far cry from stating that the foreign policy of the government has been altered. The first we can easily live with; the second we cannot.

In fact, the aircraft industry may properly be viewed in many respects as a public utility—which the government must be prepared to subsidize and bail out in the case of difficulties. To say that there exist vested interests which may legitimately be protected is different from saying that our liberties are endangered. With the passage of time many of the problems of the military-industrial complex will disappear.

Are the suppliers too ready to lure away qualified young officers from the armed services? There can be little doubt that this is embarrassingly true. Are procurement officers too influenced by retired generals who occupy positions in the supplying company? Perhaps. These problems reflect in part the newness of the relationship between the Defense Department and outside corporations. As yet no code of appropriate behavior has been formulated. No doubt in time such a code to restrain private actions should and will be formulated. To be sure, improper behavior will continue to occur in this as in other areas of our

social life. But these are problems with which our form of society must continuously cope; it is an entirely different thing from our society succumbing to the control of a militant minority.

In fact, the whole problem might very well be turned around and phrased in a more meaningful way. The relationship between the government and industry is a two-way one. Not only can the supplying industries with their military connections influence the government's policy, there is a danger that the government will use its buying power to influence business policy in an unwarranted way. With the government budget as large as it is, and with so many of the American corporations in large part dependent upon sales to the government, the government has the opportunity to force conformity upon a business community in ways which will inappropriately suppress diversity and smother initiative. This is one of the real problems of the big budget.

Of course, society can tolerate this pressure as it can tolerate other pressures. It does, however, appear that there is a greater danger that all interest groups will be homogenized through contact with the gov-

ernment than that any one interest group will ever acquire control over government's policy.

Disarmament agreement

Assuming then that the so-called military-industrial complex will not be able to block a rapprochement with the Soviets, should the realistic possibility of a settlement arise, in that case, would the nation be in a position to make the economic adjustments which a disarmament agreement would impose? There is no doubt that a sharp curtailment of defense expenditures would impose grave difficulties for a number of industries and communities. Losses would be incurred.

However, there is no reason to believe that aggregate demand need fall sharply. The government has at its disposal instruments to maintain total spending should that prove necessary. (One should remember that expenditures are likely to remain high in any event simply because the costs of policing the disarmament agreement may be substantial.) If spending is suddenly curtailed, the transitional problems for particular communities and industries may be severe. However, the resources now being absorbed in defense production can with little doubt be profitably reabsorbed in other employments, and the government may play a large role in facilitating this transfer of resources.

Earlier economic history is replete with instances of industries which have declined or died. There is no reason to believe that the difficulties associated with declining industries will be more intractable in the future than in the past. One should not, therefore, exaggerate the difficulties of making the economic adjustment to disarmament, if such a development should appear feasible.

America's needs in so many areas are very large. We must rebuild our educational system; we must support an expanding population of which an increasing proportion is nonproductive. In regard to consumer goods, a vast outlay on new housing will be required in the future. Consequently, we should not fear the economic effects of a decline in defense spending but instead should welcome the supplement to our resources. ■



ADVANCING ON AN EVEN KEEL

by KENYON E. POOLE

■ DURING THE DECADE of the 1960s the inventive resources of the authorities charged with the stabilization of the economy will be severely tested. The public has been aware, ever since the economic theories of Lord Keynes began to receive widespread acclaim during the Thirties and Forties, that severe economic fluctuations are subject to some degree of control and need not be regarded as "acts of God." Since then an increasingly sophisticated public has demanded higher and higher standards of performance on the part of the economy. People are no longer in a mood to tolerate much unemployment; at the same time they still fear the specter of inflation.

It should perhaps be added that the objective of maximum growth in our productive capacity, which played such a prominent role in the late political campaign, has seemed more intriguing to moulders of "national purpose" than to the public at large. To many people the statistics of the growth rate seem rather abstract compared to such realities as inflation and unemployment.

The background against which the effectiveness of stabilization policies must be measured in coming years is the virtual completion of physical recovery, both here and abroad, from the accumulated deficiency in plant and equipment resulting from a great depression and a great war. The Western world outside the United States is just now closing the gap that these two calamities created between actual and needed productive capital. This situation carries high promise for material welfare. But it also presents difficult problems for the transition. There is a possibility that before long most of the Western world may suffer from too much, rather than too little, capacity to produce goods and services.

Unemployment and underutilized capacity, two of the penalties of peace, have obvious implications for monetary and fiscal measures. The basic mechanism for stabilizing the



John Maynard Keynes

economy is monetary policy. By reducing the money supply and tightening interest rates the Federal Reserve authorities can dampen the inflationary effects of a boom. Conversely, the Federal Reserve can, to a certain extent, offset the effects of unemployment and recession by easing the money supply and credit rates. But monetary policy is more effective against inflation than against a low rate of investment and a tendency to unemployment. And, under the peacetime conditions just described, unemployment, not inflation, becomes the potential enemy.

Fiscal measures, on the other hand, if applied strongly enough, can put an end to any depression. Fiscal policy, involving changes in tax rates and spending programs, is in the hands of the executive branch and Congress. Though less frequently used than monetary policy, it is always ready in the background if a business recession threatens to be-

come really serious. In contrast to monetary policy, fiscal policy has generally not been applied during economic upturns. Fear of producing unemployment has led to a hesitancy to raise tax rates or reduce the size of government spending programs during an inflationary boom period.

Thus, although monetary policy will continue to be used throughout the entire business cycle during the Sixties, any tendency for periods of recession to become longer in relation to periods of prosperity will inevitably enhance the relative importance of fiscal measures.

Debt management is another weapon, though a much weaker one than fiscal policy, which can be used to moderate the business cycle. The Treasury can sell short-term securities during a recession and use the proceeds to retire longs. As the number of long-term securities in circulation is reduced, the long-term interest rate tends to come down. At the same time, spending is encouraged as more short-term securities are put into the hands of the public. This occurs because short-term securities can be more easily turned into cash without loss of principal than can longs.

The task that confronts us in achieving maximum employment and an optimum rate of growth will be complicated by the sharp increase in world output capacity. Since World War II part of the demand for American goods abroad has been based on U.S. gifts and loans. A pool of domestic employment has thus been provided which, while not preventing recessions, has contributed substantially to keeping them mild and short. However, as other countries have become more and more capable of providing their own capital needs, we have had to face the prospect of depending increasingly on domestic measures in

order to assure full employment.

Yet for this same reason we may not have the independence of monetary action that we have enjoyed since 1945. Increased competition from other industrial countries has cut the foreign demand for U.S. products. Consequently, the foreign demand for U.S. dollars has declined. This, in part, is the reason why foreign central banks in New York have accumulated more dollars than they wish to hold; they have reacted by converting a portion of these dollars into gold. Our gold stocks are not unlimited, and if this were to go on long enough, steps would have to be taken to halt the flow. The alternative, unacceptable to this country at the present time, is devaluation of the currency, which would stimulate exports and discourage imports.

There is another reason why the U.S. has less freedom in monetary and fiscal matters. Decisive measures in these fields to combat recession would mean greater spending on foreign goods as national income rose. Not only would this accelerate the gold outflow, but it would tend to inhibit even more our freedom to use monetary and fiscal policies to control recessions.

Indeed, this problem is full upon us at the threshold of the decade. The 1960-61 recession obviously called for action. But a conflict arose between the desire to stimulate investment and employment through lower long-term interest rates and the need for relatively high short-term rates to discourage the gold outflow.

Time deposits

Foreign short-term investments in this country are held, in large part, as time deposits in American commercial banks. These respond quickly to the opportunity to earn higher rates of interest in other countries. If Federal Reserve policy aims at lower interest rates (including short-term rates) through purchases of government securities on the open market, these time deposits may prove to be volatile. Foreign owners may be induced to withdraw them and sell their dollars for the currencies of countries in which higher interest rates can be earned. And the sale of dollars puts downward

pressure on the dollar rate, thus encouraging an outflow of gold from the United States.

One of the most dramatic changes in monetary policy in a decade was the decision of the Federal Reserve Board at the end of February of this year to abandon the policy of preferring short-term bills in buying government securities. The new policy was based on the hope that monetary measures can be successful in rearranging the pattern of interest rates to make short rates higher in relation to long rates. The idea is to achieve lower long rates to encourage investment, while keeping short rates relatively high to discourage the gold outflow.

Can we have it both ways? The



Walter Heller

policy outlined above is based on the view that the markets for securities of different maturities are at least partially insulated from each other. Otherwise short and long rates would rise and fall together. Some bond market experts are not confident that we can achieve higher short rates while trying to force down long rates.

In any event, it is not clear that forcing long rates down farther than they would otherwise fall during a recession is an important stimulus to investment. More important than the rate of interest in investment decisions is the prospect of rising demand for a firm's output. At the same time, the forcing down of long-term rates is a move in the right direction, and no one expects monetary policy to bring about recovery by itself.

Another major factor to be reckoned with in forecasting the performance of monetary and fiscal policy in the coming years is the change in government economic philosophy under the new Administration. In what ways may we expect that the New Frontier will involve a New Look in economic policies?

Shift of emphasis

President Kennedy and the Chairman of his Council of Economic Advisers, Walter Heller, have made it clear that they are more concerned with accelerating the economy's growth rate and achieving full employment than they are with the danger of moderate inflation. This shift of emphasis is bound to have an impact on policy, though we should be careful not to exaggerate the probable extent of the change.

The Chairman of the Federal Reserve Board, William McChesney Martin, in testimony before the Joint Economic Committee of the Congress in March, stated that fiscal policy might well do more of the job of controlling inflation, thus taking some of the burden off monetary measures. Nevertheless, he insisted that the control of inflation still remains a prerequisite "to achieve our over-all stabilization goals." It seems clear, in view of the independence of the Federal Reserve from the executive branch, that policy aimed at promoting economic growth and stability will continue to be tempered by concern with inflation.

It is interesting to look a little further into the difference of opinion on the role of rapid economic growth in helping us to achieve price stability and full employment. Mr. Heller has expressed confidence that the "hard core" of unemployment will largely disappear after monetary and fiscal policies have produced "an environment of full prosperity." It is his hope and expectation that if we can engineer a rise in the rate of growth we can at one stroke virtually eliminate unemployment while contributing to stability in the price level.

But stimulation of the growth rate requires accelerated private and public investment. This, in turn, is likely to lead to a rash of price rises.

How, then, can price stability be achieved by this method? The answer given by many economists is that a controlled rise in investment (including government investment in schools, roads and human capital) leads to a rise in output as well as an increase in productivity.

On both counts, it is pointed out, the effect is anti-inflationary. After a time lag, rising output will work to soften the price rises caused by the accelerated investment; at the same time rising productivity will lower costs of production and thus tend to lower prices. This assumes, however, that increased productivity will not only swell profits and wages, but will also result in lower prices to consumers.

This view is opposed by those who stress that the first thing that happens when investment spending rises is that an upward pressure is exerted on prices. This is particularly true of government spending, which does not usually result in a marketable product to absorb purchasing power. Thus, there is the danger of setting in motion a spiral of rising prices and costs before we begin to benefit from increased output and higher productivity.

There is no way to test the two opposed views except to try the experiment. The present Administration may be willing to do so. At any rate, we are not likely to hear much from within the Administration about the need to insert a price inflation control clause in the Employment Act of 1946.

Inflationary pressure

If it turns out that a by-product of accelerated investment aimed at growth is inflationary pressure, the task of fiscal and monetary policy will assume a new dimension in the Sixties. On the one hand, the Federal Reserve Board will be under pressure to support the high employment objectives of the Administration; on the other hand, both monetary and fiscal measures may be needed to keep down the rate of inflation.

Will the Kennedy Administration move more rapidly against recession than other administrations have in the past? Both the Eisenhower and the Truman Administrations had a healthy fear of inflation. They also

feared to expand spending programs and unbalance budgets in order to achieve full employment. They did not favor novel fiscal measures. The possibility of stimulating personal spending through temporary reductions in the income tax rates was never seriously considered. It was left to liberals like Sen. Paul Douglas (D-Ill.) to carry the banner for this potentially effective, but untried, antirecession fiscal policy.

The Kennedy Administration may prove to be more aggressive. Some steps have already been taken. The promise was given earlier that increasingly strong measures would be taken after 75 days if they proved to be needed. Though this indicated flexibility of purpose, never-



William McChesney Martin

theless it implied a cautious policy. The economists of the new Administration style themselves "pragmatists." They are prepared to modify policies as circumstances dictate. This appeals to common sense, but it does not sound revolutionary.

Many of the problems connected with achieving stable economic growth involve trends that have been under way for some time. Prominent among these are population growth, shifts in population, and the development of pools of unemployed labor due to automation and the difficulties confronting declining industries.

Unemployment produced by these causes cannot be effectively countered by a combination of monetary and fiscal measures. In terms of results, the proper approach would be to re-educate and reassign displaced labor, to employ the tem-

porarily unemployed on public works projects and to provide for the retirement, through social security and other measures, of those who are too old to be retrained. To try to eliminate this kind of structural unemployment through monetary and fiscal measures designed to raise the level of total spending is likely only to give these measures a bad name that they do not deserve.

This is true because the social cost of trying to eliminate structural unemployment through such measures could be high. First, it requires more and more monetary ease and federal spending to eliminate the last vestiges of this type of unemployment. Second, the policy would tend to accelerate the rise in inflationary pressure.

Economic liberals maintain stoutly that they are prepared to risk whatever inflation is required to accomplish the humanitarian objective of eliminating structural unemployment. But there is no denying that to do it through measures designed to raise the level of total spending is to make use of a bulldozing technique, and many economists believe that specific methods more directly related to the causes are preferable. It is widely felt that there is no guarantee that a mild inflation, subjected to this kind of pressure, will not spiral into something a good deal more serious.

If we are to assess accurately the contribution of monetary and fiscal policy to full employment in the years to come, it may prove highly desirable for the Department of Labor to publish two series of unemployment statistics. One should give the figures of unemployment due to special conditions (automation, depressed areas, a sudden bulge of men and women entering the labor force, and so on). And the other should measure unemployment caused by deficient aggregate demand.

This could be much more than a statistical device. It would have the advantage of making clear the distinction between the two kinds of unemployment. We might in this way avoid the temptation to ask monetary and fiscal policies to attack structural unemployment—a job for which they are decidedly not well adapted. ■

How Much Growth? How Soon?

by **GERHARD COLM** and **PETER WAGNER**

■ ECONOMIC PROJECTIONS are much more than dry statistical forecasts. They have become means by which we can mold our thinking about the future. Projections for coming years on the basis of recent rates of economic growth are becoming an increasingly important issue in the cold war. The Russians contend that their total production will, within a decade, make the Soviet Union the greatest economic power on earth. If this happens the political consequences will be far reaching.

The Soviets' forecast is, however, based on two assumptions. The first is that their economy will continue to grow at the same rate as in recent years—eight per cent per annum. The second assumption is that the rate of growth of the U.S. economy will be only 2.3 per cent a year—the figure for the last five years, excluding the 1960-61 recession.

The Soviet Union is not the only country that is currently growing at a faster rate than the United States. The countries of the European Common Market have been growing at about seven per cent per year and Japan at a still faster rate. Great Britain, however, like the United States, has been developing at a much lower rate.

There are reasons why the Soviet Union, the countries of Western Europe and Japan have achieved a higher rate of growth than the United States during the post-war era. Our economy did not suffer from the ravages of war, and we did not face the same challenge of having to rebuild it. Nevertheless, the question of the development of production in the United States is of crucial importance and cannot be dismissed as a mere talking point in national or international politics.

Throughout the country there is a growing recognition of the urgency of the tasks which need to be undertaken to improve the quality of life in the United States. If we could be sure that international tension will relax during the coming decade, it would be possible to allocate to civilian use some of the resources now devoted to defense production. While we can hope that this will be possible, we should recognize that even greater national defense expenditures may become necessary. Moreover, even a substantial degree of disarmament would require large and continuing expenditures for arms control and an international police force; meanwhile the need for international assistance to less developed nations would persist. Thus, disarmament would alleviate but not solve the problem of financing our domestic needs.

Much has been written in recent years about our domestic deficiencies in education, health services and the use of natural resources, such as water. Particularly, the rebuilding of our cities and our metropolitan transportation systems is a task whose dimensions stagger the imagination. While modern technology has been applied, to some extent, in the field of national defense, the whole area of nondefense public services is still largely geared to 19th century technology and attitudes. The public sector will require very large investments in the Sixties.

It has been suggested that these large outlays for expanded public services can be made without an increase in production. Since in an "affluent society" so much money is spent on frills, many feel that present levels of production would be adequate to the task if there were

a reallocation of resources. Such a reallocation would involve the curtailment of luxury consumption by means of increased tax rates, thus making more resources available for expanded public services.

However, it must be recognized that, except in a real emergency, our present high tax rates rule out this possibility. Such a proposal would probably meet severe opposition and might have undesirable effects on both prices and employment. The only painless way to enlarge tax revenue is to increase the rate of growth. This would automatically provide higher yields from existing tax rates. For instance, let us assume that the economy's rate of growth can be increased to about 4.5 per cent per year during the rest of the decade. Then, by 1970, total government expenditures could rise from the present \$140 billion to about \$220 billion with no increase in tax rates and no resort to inflationary financing.

Thus, increased economic growth is a desirable goal, not because of some national or international statistical race, but because it would permit us to provide the services needed to make life in the U.S. more secure and livable; it is also necessary if we are to assist other countries in solving their problems.

Before we consider how much economic growth we are likely to attain in this decade, let us take a look at a previous forecast. In 1952, the National Planning Association published a pamphlet, "The American Economy in 1960." This study estimated that total production of goods and services (gross national product or GNP) would increase from \$329.2 billion in 1951 to \$425.6 billion in 1960 (measured in 1951 prices). When expressed in 1960 prices the figure for the 1960 GNP was \$505.5 billion. This estimate proved to be almost exactly accurate for the GNP of the first half of 1960.

Thus, economic projections *can* measure future growth; it must be recognized, however, that the accuracy of this 1952 forecast was partly due to coincidence. For example, the 1952 estimate assumed that 1960 would be a year of approximately full employment. Actually, even during the prosperous first half of the year, unemployment averaged over

five per cent, indicating the existence of unused resources.

This sort of estimate is called a *projection*, that is, a forecast based on a number of assumptions. Such projections estimate the future production of goods and services on the basis of our existing national attitudes, goals and institutions. Underlying all the assumptions made is the belief that this nation will not tolerate any substantial deviation from the goals set forth in the Employment Act of 1946; thus a serious depression or a serious inflation is ruled out.

Each year the National Planning Association's National Economic Projections Service estimates the goods and services that will be produced by the major sectors of the economy during the next five and 10 years. For the 1960s a rate of growth between four and 4.5 per cent per year appears feasible, assuming that recovery from the current recession will bring us near full employment in 1963 and that future recessions will not be severe or of long duration.

The factors determining potential economic growth are: (1) changes in the labor force, (2) changes in hours of work and (3) increases in output per hour of work (productivity) in major sectors of the economy. [See chart below.]

The labor force increased by just over one per cent per year between 1951 and 1960; on the basis of population trends it is expected to rise by about 1.7 per cent every year during the coming decade. This assumes a moderate trend toward somewhat earlier retirement.

Average weekly hours of work have been declining by nearly four per cent per decade over the last 80 years. Some people recommend a more rapid reduction in the workweek as a device for reducing unemployment, particularly in a period of rapid gains in productivity. But if it is true that an increase in production is desirable in order to meet the needs of public and private demand, a drastic shortening of the workweek in order to "spread the work" would be a move in the wrong direction.

Take-home pay

Also, most workers probably prefer continued wage increases to reduced working hours; this implies that labor would not be willing to accept shorter hours if that would mean a reduction in weekly take-home pay. If hours were reduced and hourly wage rates increased sufficiently to hold incomes steady, labor costs would go up and the problem of international competitiveness would be aggravated. Therefore, the authors of this article estimate that hours of work will only gradually decline—from the 40.1 hours per week in the first quarter of 1960 (before the recent recession) to about 38 hours in 1970. For the most part this decline is expected to take the form of longer paid vacations and additional holidays; only in the latter part of the decade is a reduction in the standard workweek likely.

Productivity gains (output in constant dollars per man-hour) in the private sector of the economy have been achieved at an average rate of

2.2 per cent per year since 1925. In the immediate postwar years much new equipment was installed and output per man-hour increased at a faster pace than before. During the current decade we expect a new rise in productivity gains as a result of wider adoption of automation and other technological advances.

Delayed impact

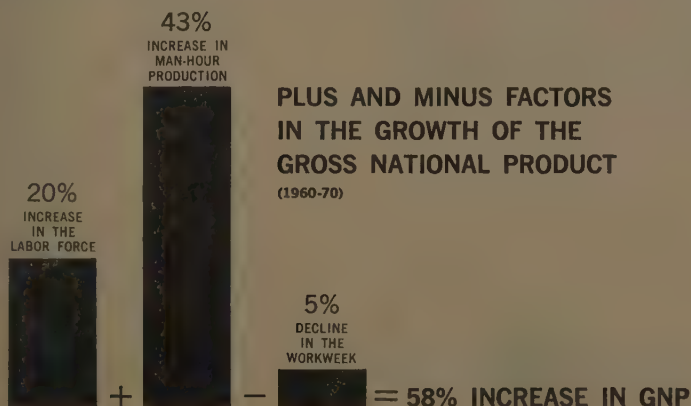
But the full impact of such advances is usually not felt until a few years after their initial adoption. This happens because much labor is needed to experiment with, produce and install the new equipment. Thus, we have estimated that the increase in productivity for the private economy as a whole will be 3.3 per cent per year for the next decade—about the same as it was during the first postwar years. If the increase in productivity should become greater late in the decade, it may in part be offset by a more rapid curtailment in hours of work.

These estimates add up to a growth in output at an annual rate somewhat above 4.5 per cent for the decade. However, it is well to remember that the U.S. entered the 1960s with considerable unused resources of labor and capital. Once reasonably full employment has been reached, we estimate that annual growth will continue at a slightly lower rate—4.3 per cent.

This will produce a GNP (measured in constant 1960 dollars) of nearly \$800 billion in 1970 as compared with approximately \$500 billion in 1960. Taking into account the expected increase in the population, such a GNP would mean that personal income after taxes would amount to about \$2,700 per head in 1970 as compared with nearly \$2,000 in 1960. Expressed in another way, it would mean almost \$11,000 per family of four (compared with less than \$8,000 in 1960).

An \$800 billion GNP would permit us to increase government expenditures for domestic and international purposes by about \$80 billion without increasing tax rates or resorting to inflationary financing. And it would allow business investment to reach a level of about \$87 billion, thus laying the foundation for continued growth in the 1970s.

The possible increase in the pro-



duction of goods and services which we have outlined above may remain a dream or become a reality. The outcome depends on the policies adopted in the meantime.

Our first task is to restore a high level of economic activity. We do not know when the recovery will get under way; nor can we know how vigorous the upturn will be. It is probable that it will have started by the time this article is published. On the other hand, the fact that the "Soaring Sixties" started with a recession has led some to a pessimistic outlook on the decade as a whole.

During the 1955-60 period we had a rate of growth of about 2.3 per cent per year. If we do not do better than that during the next few years the gap between potential and actual production will widen. If this happened we would soon have a rate of

that are likely to become ready for practical application should permit an increase in productivity at least as marked as that of the immediate post-World War II period. Considering all these factors, a sustained rate of growth of 4.5 per cent appears to be a necessary and realistic goal. We see no reason to assume that this goal cannot be attained.

The following graph illustrates the job to be done. The lower line shows the projected GNP if growth continues at 2.3 per cent a year. The upper line shows the projected GNP which would be obtained in a reasonably full employment economy—defined as one in which no more than four per cent of the labor force is unemployed. For 1960 there is a \$30 billion gap between the \$503 billion of the bottom line and the \$533 billion of the top line. By 1970

fective policies our potential growth is not likely to be realized. On the contrary, the fabulous technological advances which are in store may lead to continuing and rising mass unemployment, unless adequate numbers of new job opportunities are created. During the next 12 months alone more than seven million additional jobs are needed. These jobs would reduce unemployment and underemployment to a level of four per cent of our labor force by absorbing both the displaced workers who are the victims of technological progress and the new entrants into the labor market.

Job opportunities

In our economic system, job opportunities are created primarily by private enterprise and secondarily by government. The four recessions during the last 12-year period, though they were relatively mild, were certainly discouraging for business enterprise.

There are various actions the government could take to promote more steady economic development and increased investment in plant and equipment. One would be to support total demand by means of monetary and fiscal measures.

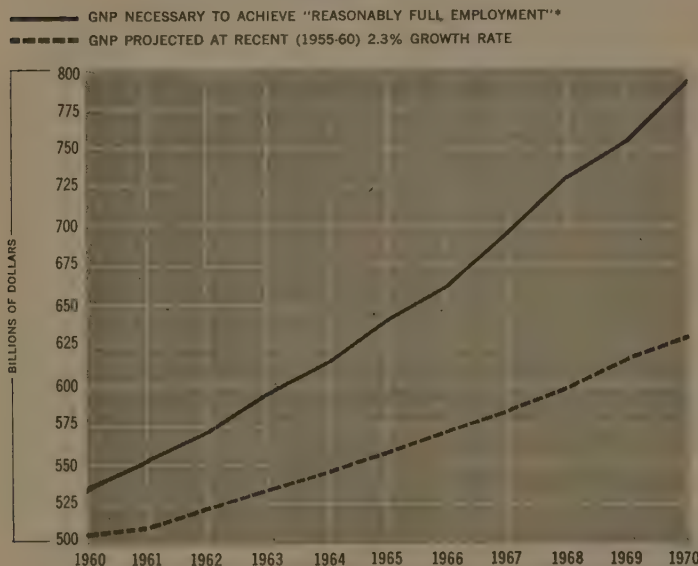
In addition, government support of both pure and applied research, the backbone of technological advances, is becoming increasingly vital. Technological advances are important not only because they increase production but because they are our only hope of maintaining and improving the international competitiveness of American industry. This is particularly so because labor will claim higher wage rates and more fringe benefits as its share of our increasing prosperity.

Finally, government measures to induce business to replace obsolete plant and equipment more promptly might be useful.

However, as long as the economy is operating at a recessionary level, the main objective of government policy should be to promote recovery and, even more important, to ensure that the recovery will be sustained. In recent recovery periods, the increase in demand fell short of the increase in capacity. Excess capacity continued to exist throughout these periods and cut short their duration.

GNP PROJECTIONS, 1960-70

(IN 1960 PRICES)



*"Reasonably full employment" is defined as an unemployment rate of not more than 4% of the labor force

unemployment in excess of 10 per cent.

Even a rate of growth of three per cent to 3.5 per cent, which we had over the long pull of the past 50 or 60 years, would not be adequate to take full advantage of the expected increases in the labor force and in production per man-hour. The technological and managerial advances

the difference grows to \$167 billion. To close the gap we need to achieve a higher employment rate. This could be done by 1963. Then we must make sure to maintain an adequate rate of growth.

Economic expansion is entirely feasible without requiring any drastic changes in our economic and political institutions. But without ef-

Growth is supported by a process of simultaneously increasing demand and productive capacity. Although these can never be in exact balance, policies to achieve an approximate balance at high growth rates are necessary. Policies are also needed for allocating resources between public and private demand, with an increase in public activities receiving first priority.

If it were not for the urgent need for expanded public programs, a substantial tax reduction would probably be possible and necessary to produce a high rate of growth. Lower taxes would encourage private demand to increase in proportion to increased productive capacity. Some tax reduction may be warranted in spite of an increase in nondefense expenditures of government, unless national security programs need to be stepped up substantially.

Economic projections can be of great help in appraising alternative public policies for promoting economic growth. They are also useful for business enterprises. If the managers of business use only the ups and downs of current markets to guide them, business investments will fluctuate greatly. When they make decisions to invest in new plants and modernized equipment, it is important that they evaluate the future of their own products in the perspective of the growth of markets as a whole. Well based economic projections can provide such perspectives for important business decisions.

Announcement effect

Indeed, if the business community could be confident that the government would adopt the policies implied in such projections, these forecasts would have an "announcement effect" on business behavior. The projections would thereby contribute to the attainment of our economic goals and come closer to being an accurate mirror of future reality.

It is necessary, of course, that projections be realistic. If they are to be useful, they must not be mere quantitative expressions of wishful thinking. On the other hand, they should not be overconservative because government and business would then set their sights too low, failing to

make full use of their economic potential in the face of great domestic and international needs and neglecting to create the job opportunities that will be needed.

In making their projections, then,

economists must plot a course between the Scylla of optimism and the Charybdis of pessimism. If they can succeed in this task, they will make a vital contribution to the economic future of our country. ■

The Sixties — the free world's economy

Needed: a Declaration of Interdependence

by HENRY G. AUBREY

■ THE TURN OF A DECADE may be an arbitrary benchmark in the long perspective of history. Yet, it so happened that the year 1960 marked an historic turning point in American foreign economic relations. To be sure, no dramatic events occurred, and the significance of what happened may not become apparent to the public at large for some time. But it was the year when the United States had to ask Western Europe, particularly Germany, for a greater contribution toward the West's mounting foreign burden. It was also the year when it was decided to replace the Organization for European Economic Cooperation (OEEC), an all-European body, by the Organization for Economic Cooperation and Development (OECD) in which the U.S. and Canada were to be full-fledged members.

Thus, four decades after Wilson's failure to make this country "join the world," less than two decades after the Atlantic Charter and after a little over a decade of being only a patron and observer of OEEC—the great transformation of our international relationships has been completed. In contrast to the benevolent paternalism of the Marshall Plan period, we have adopted a more egalitarian type of association. Actually, since this country lost its immunity against balance of payments difficulties the plain fact is that we are as much in need of cooperation as Europe. And there may be more

scope for genuine cooperation when all partners have something to lose as well as something to gain.

Yet, the growing sense of interdependence is rooted in more than the belated recognition of our financial vulnerability. In the military field, we are having second thoughts about our grand strategy. As more nations build nuclear weapons, as American bases overseas become endangered by shifts in foreign sentiments and as the danger of brush fire wars increases, we become more and more aware of the necessity of a cooperative approach to security. The forces of nationalism are crowding us in the Western Hemisphere and the wisdom of unconcerted moves is becoming more dubious, as the British and French learned at Suez. By attempting to do too much alone, we run the risk of seeing Cuba become our Suez.

In our economic relations with the Communists our "splendid isolation" is also becoming an anachronism, as our best friends trade ever more with the Sino-Soviet bloc in the face of our studied posture of withdrawal. We may not be able to continue this policy much longer, and trade cooperation will then emerge as ineluctable.

In fact, Communist exports may, at any time, confront us with the need to reassess our international trade policies with regard to both our allies and the Soviet bloc. There have been sporadic Soviet incursions

in Western markets before—in tin, aluminum and platinum. They could be explained in economic terms, even though the circumstances and timing may have reflected some political malice. It was possible to settle these past disruptions by *ad hoc* commodity agreements—East-West economic cooperation, if you please. But the commodity strategy of the Soviets is subject to change without notice. And in that event they will not hesitate to implement their tactics of the moment to the detriment of the world markets, which are the West's creation and responsibility, not theirs.

Moreover, due to poor crops and the need for advanced Western-type equipment, Communist bloc imports will rise. To pay for them, greater exports must be expected, unless the Russians decide to sell more gold to the West. When Communist exports come pouring into Western markets, joint action in defense of those markets may be imperative.

Joint commodity strategy

Actually, a joint Western commodity strategy would be needed even in the absence of the Communist threat. The producers of primary commodities in the less developed regions find it ever harder to make ends meet. True, they are being wooed by the Communists in an all-pervading climate of competitive coexistence, and this makes the problem more acute and the penalties of neglect more severe. Yet, our relationship with the awakening nations would, in any event, demand increased attention to commodity trade. For, through such trade the developing nations receive the wherewithal to pay for their imports; it is their lifeline to the Western markets.

Time was when it was still possible to stand aside and let the markets work their own slow way through crisis to recovery. Today, when such instability of trade plays havoc with the economic health of many countries desperately seeking development, it is no longer feasible to let events take their course and to remain indifferent to the social and political consequences.

It would be both poor economics and bad politics, for the Sino-Soviet bloc stands ready to reap the bene-

fits of the chaotic situation that would result. The internal forces of revolutionary ferment and anti-Western nationalism would mount, thereby threatening to alienate the underdeveloped two-thirds of the world from us. Unless these areas can develop in a manner that is compatible with our system—or at least not antagonistic to it—we would eventually stand alone, perilously exposed.

No more than a start has been made in recognizing the trade problems of developing countries. The United States and Great Britain, who until recently did not even want to join the discussions of the U.N. Commission on International Commodity Trade, have now changed their attitude and participate, albeit somewhat reluctantly.

It is quite true that interference with the market mechanism is risky and the effects uncertain. Yet, the issue cannot be shirked any longer. Without American initiative little will be done, and without active American participation nothing can be achieved. But the problem is too large for the United States to tackle alone. This country is the world's largest trader, but Western Europe as a region imports about twice as many primary products. Thus, the task must be a joint effort; a coordinated Western commodity policy has to be designed.

Cooperation will be needed not only to attempt a dampening of cyclical fluctuations and their amplified effect on the price and trade volume of primary commodities. Commodity trade represents a long-term trade problem of the developing countries as well as a cyclical one. Industrial countries have not been increasing their imports of these goods nearly so fast as their incomes have been rising. Synthetics and other domestic substitutes are replacing imported materials, fuels are being used with greater economy and domestic services tend to command a greater share of national expenditure.

There is not much that governments in advanced countries can do to counteract such technical or structural developments. But their policies have often obstructed imports from the underdeveloped world in order to serve domestic in-

terests. We have placed quotas on our imports of certain metals and petroleum, and induced Japan to impose "voluntary" quotas on certain manufactures. Britain did the same with regard to Commonwealth textiles, and no less than 14 European and Commonwealth countries are still denying Japan most-favored-nation treatment under an obsolete GATT escape clause. Virtually all industrial countries are guilty of agricultural protectionism. And many European countries have excessive tariffs or taxes on such tropical agricultural products as coffee, cocoa or tea that are not even designed to assist domestic production.

Production of new countries

Clearly, much remains to be done before the developing regions will have full access to the growing markets of the advanced countries. Where are the new countries to sell the production of their new industries when it is in excess of the needs of their domestic markets? From an economic point of view it would be quite rational for the developed nations to permit the products of labor-intensive industries to enter their borders and concentrate their more abundant capital and superior skills on goods requiring more complex processing.

Admittedly, this can be painful to certain industries and may require deliberate policies of adjustment with government help, such as those made in re-equipping and reducing the capacity of Britain's textile industry. But it is not easy to muster political support for isolated actions. It may be easier to take effective action on this issue if it becomes a matter of common Western concern, as part of the considerable foreign policy problem that underlies it. In any event, collaboration will be required to work out the techniques and to share the burden of the impact among those affected, in recognition of the economic-political reality that confronts the Western world.

This trend of thought also opens our eyes to a problem that the Communists have long recognized. Should trade and aid policies really be approached independently, as they commonly are by Western nations? Aid to a country whose trade

lags for any number of reasons may help only temporarily. A stabilization loan provides foreign exchange, but it is no substitute for the income lost through the trade lag. The Communist bloc offers aid that is repayable in local products; trade is thus expected to pay for aid. Conversely, trade looks like aid if surpluses can thereby be converted into imports of development goods. Intuitively, or as a result of shrewd analysis, the Communists deal jointly with trade and aid problems.

So far, at least, this has not been

financial and monetary field. The recent gold flurry and concern with the future of the dollar provide a salutary impulse for reflection and consultation. The Triffin plan (see *Gold and the Dollar Crisis*, CHALLENGE, November, 1960) and other proposals for reform of the present monetary system point in new directions.

Yet, one wonders, is it useful to dabble with payments and currencies without also considering the underlying problems of trade, investment and aid? Unless there is a

fairs, it is still there for all to see.

A new institution is often the way—if not necessarily the most efficient one—for a new departure. OECD is a new vessel ready to be filled with as much content as the participants are willing to spare from their jealously guarded store of national prerogatives. The most essential, if also the most elusive, ingredient is a will to achieve unity.

Western Europe has been struggling for unity for some time. Some success has been registered—but at the cost of a widening split between the two trading groups, the Inner Six and the Outer Seven. It is hoped that OECD can heal the breach, though it is hard to see what it can attain that the two sides could not themselves accomplish. Yet, as a catalyst of consultation, coordination and action, OECD could indeed achieve much if—and this is an important proviso—the need is acknowledged and the will induced. This calls above all for understanding, education of the public and policy planning at home. A huge task indeed, but is it mere wishful thinking to believe that we can accomplish what we must?

This is indeed the challenge, and the decade of the Sixties will be the time when our determination will be tested. It would be futile to forecast what the decade will bring. But it is possible to outline what we should accomplish. And there is a chance that the Communists will help the United States by pushing it along a path many Americans would not willingly have chosen. We are a people of insular disposition—a disposition enhanced by the illusion of independence we have within a continent-sized economy—and the idea of increasing international collaboration at the cost of some sovereignty does not come naturally to us. Great changes are rarely brought about without a sense of a clear and present danger. With the Communists breathing down our necks, we may move faster than we would without the goads of cold war and competitive coexistence.

True, most of the problems other than defense would exist even in the absence of the Communist threat. Grave imbalance in world trade would call for remedies simply because the non-Communist world is



the Western way because trade, public aid, private investment and other types of finance are institutionally separated in our system. Yet all are important to the less developed countries because they are functionally linked in economic growth. Such a comprehensive approach is too new for any single Western country to attempt alone. The broader the issue and the more urgent the task, the greater is the need for coordinated thinking and cooperative action by the Western nations.

It has now become evident that the approach of "sharing the burden" is far too narrow if it simply means a greater European financial contribution to military expenditures and foreign economic aid. The bilateral tack taken by the ill-fated Anderson mission to Germany ran counter to our accepted concepts. Whatever may have been achieved by transmitting a mood of urgency in Germany, the approach missed the fundamental point of multi-lateral collaboration. The task is so great that it cannot be successfully met by one or two countries alone.

Undoubtedly, finance is also an important issue, but it, too, cannot be handled in isolation. True, much more could be done—and will certainly be done—in the international

will to recognize the interrelation of all international economic issues, and unless all concerned collaborate in their efforts to solve the problems involved, those issues can only be approached in a haphazard, slipshod and piecemeal fashion.

If all these issues are squarely faced—and their complexity and interdependency acknowledged—the United States will have little choice but to seek more collaboration with partners of like mind. This means a great deal more give-and-take than the United States is accustomed to, and it will not come easily. The fear of "entanglements," handed down through history from the founding fathers, still lingers. Blanket commitments by the Executive without specific Congressional approval still are many a legislator's nightmare.

Tortuous course

The tortuous course of our negotiations for a constitution for OECD with American membership is a case in point. And after the treaty was finally hammered out by the member nations, still more i's had to be dotted and t's crossed in order to obtain the approval of the U.S. Senate. Yet, though many seemed determined to close their eyes to the inevitable trend in international af-

the world market and its health is our business. The poor nations which comprise two-thirds of the world would clamor for development in any event. Yet the gulf between their standard of living and that of the advanced areas has become so wide that it is doubtful whether it can ever be filled.

The least the industrial countries of the West can do to help lessen it is to try to provide what we have come to consider the birthright of free men—equal opportunity to embark on the great adventure of self-sustained growth. But the underdeveloped countries are already too far behind—and too enmeshed in the

vicious circle of low incomes and rising population—to achieve the necessary impetus unaided. If the West lets them down, they are apt to make the attempt with Soviet help and by emulating the Communist method.

If the West wants to avoid this contingency, it has to act decisively and in a concerted manner to counter the attraction of the Soviet example. This is the only way to demonstrate that extensive development can be achieved by democratic methods. The challenge is quite evident, and the need for action has been acknowledged in scattered statements. But, so far, there has been virtually no coordinated re-

sponse by the West as a whole. And while the task is obviously too large for any country to undertake alone, systematic action has barely begun.

What is needed is a drive for greater unity, commensurate with the magnitude of the job at hand. To galvanize the Western community into common action—and the Marshall Plan proved it can be done—a clearer recognition of both the need and the path is essential. The land has been surveyed and the destination set. But the road to collaboration remains to be built. How swiftly can we complete the task of construction? This is the great issue for our international policy in the Sixties. ■

A vital economic issue of the Sixties

FINANCING THE DUAL ECONOMY

by **ALVIN H. HANSEN**

■ A PARTNERSHIP between private enterprise and government will, in my opinion, become increasingly necessary. The role of private enterprise is now, and will continue to be, primarily that of producing a rich and varied supply of material goods. Owing to automation, however, employment in the material goods sector is declining. Employment in the service area is rising. Just as private enterprise serves best in the material goods sector, so government serves best to satisfy our cultural needs. The role of government will increasingly be that of providing a wide range of services—those services which we have come to associate with the welfare state—social security, health, housing, education, recreation and cultural programs, and community projects.

The further we move into the Dual Economy, the more we shall encounter two problems: (1) the availability of funds for private capital formation and for industrial research, and (2) the "shrinking tax base" as the government sector grows larger and larger relative to the pri-

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ate sector. Where is the money coming from to keep the Dual Economy going?

Consider first the sources of private investment funds. Formerly such funds came primarily from stock subscriptions, bond issues and bank loans. More recently investment funds have come primarily from internal sources, namely, retained profits, depletion allowances, depreciation and amortization charges. From 1955 to 1959 inclusive \$138.2 billion came from internal sources while only \$58.2 billion came from bank loans, mortgage loans and new issues of securities.

In the earlier stages of development profits were necessarily rather meager, and so relatively little reliance could be placed on retained earnings as a source of funds. One had to look outside of the enterprise

itself for investment funds. Capitalists and banks had to be found that were willing to assume risks and advance the funds necessary to start new enterprises. In the earlier stages of our history as an industrial nation, depreciation allowances played only a small role in new capital financing. The aggregate accumulated stock of plant and equipment subject to depreciation was small. Moreover depreciation accounting had not developed to any high degree of expertness.

Equally important is the fact that, in the days when numerous producing units occupied each industrial field, prices and profits were controlled by competition. Retained earnings could not be "planned" to the degree that is possible under oligopolistic and quasi-monopolistic conditions. In the recent drug hearings in Washington corporation heads testified that fantastically high markups were deliberately made in order to provide ample money for research.

Prior to the advent of "administered" prices, funds for research or

for investment in plant and equipment were more dependent upon the capital markets and on borrowings from banks. Savings and bank credit were the primary sources of investment funds. But now funds for investment may be tapped from consumers via high administered prices bolstered by high-pressure advertising. As far as outlays on research are concerned, this is all the more true since the tax reforms of 1954 permit research outlays to be deductible as current expense. Under this procedure research outlays are made a part of cost to be covered by an adequate price. Prior to 1954 such outlays were regarded as a long-term investment, deductible over a period of years.

When investment funds are obtained from the capital market, those who supply the funds have a voice in the business. In the final analysis stockholders control, and banks and bondholders have at least a contingent voice. In any event they are paid dividends and interest for their participation. But nowadays the consumer, via the administered pricing system, pays a price sufficiently high to cover current research outlays and depreciation allowances, and in addition sufficiently high prices to provide profits not only for dividend payments but also for adequate retained earnings. This is taxation without representation.

It is said that about one-half of total medical research in the United States is paid by the federal government, one-fourth by universities and one-fourth by drug manufacturers. Government research is paid by taxes imposed by an elected Congress. The taxpayers elect the legislators who vote the appropriations. But the consumer who pays prices which are higher than necessary to cover costs (including normal or "competitive" profits) is in the final analysis the one who supplies the funds which are plowed back into businesses operating under the system of administered prices.

The average annual investment made by corporations in plant, equipment and inventories in the period 1955 to 1959 inclusive was \$31 billion. Internal sources (retained earnings, depreciation, amortization and depletion allowances) averaged in this period \$27.6 billion.

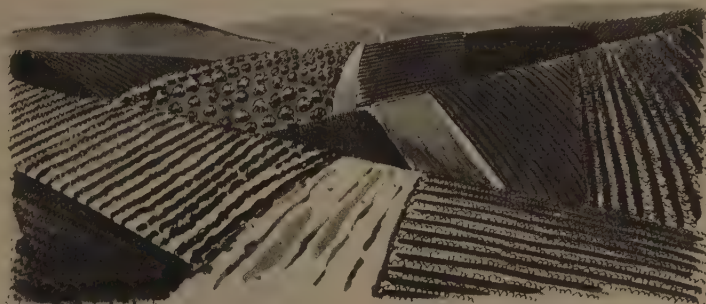
Internal sources were therefore sufficient to finance exactly 90 per cent of the aggregate investment in *fixed capital and inventories combined*. Outside sources of funds (bank loans, mortgage loans and new issues) were tapped to cover the remaining 10 per cent and to finance net accumulations of cash, securities and net receivables.

Depreciation and amortization allowances now supply two-thirds of the funds spent by corporations on plant and equipment. Depreciation allowances have been increased not only by more generous tax treatment, but also by the fact that an

velopment it is doubtful if we could have obtained the investment funds needed for growth and expansion. Clearly, however, this development raises questions with respect to governmental supervision or control.

And now the question: Where is the tax money coming from if the private enterprise base, though growing absolutely, is undergoing a relative decline?

Unless one has given considerable thought to this question, the instinctive answer is that private enterprise is the only true source of income. All incomes, so it is argued, are derived directly or indirectly from private



enormous amount of new corporate plants and producers' equipment have been built in recent years (post-war backlog and new techniques). This vast accumulation of new productive facilities is generating a huge volume of depreciation allowances. And the fact that so much of the plant and equipment is new means that replacement is a long way off. Accordingly the depreciation funds can immediately be used, not for replacement, but for net additions to the stock of fixed capital. And those new capital assets, in turn, are again subject to depreciation. In a growing society you are always ahead of the game. Depreciation allowances tend to exceed replacement expenditures. In 1955-59 an annual volume of nearly \$19 billion of corporate depreciation funds was available for investment, and currently it amounts to nearly \$23 billion. In addition there are the retained corporate earnings, amounting in 1955-59 to \$9 billion per year.

We have thus reached a new, and perhaps necessary, stage in financing private investment. Without this de-

enterprise. Governments obtain their income, it is said, from private enterprise. This works all right as long as the government sector is relatively small. But what will happen, it is asked, should the government sector grow and grow in relation to the private sector? Will not the true source of funds, under these circumstances, eventually dry up?

Frequently one hears the comment that the payrolls of private industry are the source of the whole national income, that government is supported by business, that private enterprise alone is productive.

Here we can learn from the early classical economists. Adam Smith introduced a novel idea into economics—a new concept of productivity. The physiocrats had held the view that agriculture alone was productive. Agriculture supplied the necessities of life for the agricultural population, and if there was a surplus left over, it was possible out of this "net product" to support the "unproductive" town population.

It is not difficult to see how the physiocratic concept of productivity

was born out of the conditions emerging from the Middle Ages. Towns originally were simply the winter residences of great feudal lords. The town population grew up around the court. It performed personal services, prepared food, made rich clothing and ornaments, jewels, laces, velvets, tapestries, clocks and furniture. All this activity was supported and sustained from the surplus which the lord was able to draw from his agricultural domain. Without this surplus, life in the town would quickly ebb away. The town had no independent source of subsistence. It drew its sustenance from the country.

Town life was a luxury which could only be supported out of a richly productive countryside. Town life could develop only so far as an agricultural surplus could be produced and, through feudal rights and privileges, drawn off from the land to enrich the town life of the landed aristocracy. If king and country were to become rich and powerful, it was necessary to encourage agriculture. Agriculture alone was really productive. All other pursuits were sterile and unproductive. This was the doctrine of the physiocrats.

Fountainhead of wealth

The thesis that agriculture was the fountainhead of all wealth, that agricultural pursuits alone were productive, was once and for all disposed of in Adam Smith's great book *The Wealth of Nations*. The view he challenged had seemed so self-evident and plausible that none had seriously questioned it, precisely as is the case today with respect to the role of government. Yet increasingly, as manufacture and trade developed, it was inevitable that sooner or later it would become apparent to an original mind that the old thesis simply did not fit the facts of a more highly developed society.

The opening paragraph in *The Wealth of Nations* strikes directly at the fallacy of the *produit net* philosophy. Smith regarded labor, not agriculture, as the basic source of wealth. Through division of labor and exchange, productivity is increased. If one exchanges one's agricultural surplus against the products of specialized and efficient town craftsmen, one increases one's own

product. Exchange with the town enriches the country.

Now, in point of fact, this analysis did not represent merely a new interpretation of the same facts. To some extent the facts themselves had changed. At the earliest emergence of town life, the town, as we have noted, was simply a collection of families catering to the wants of the lord and his court. It had no independent existence. The activities of the town represented the lord's method of consuming his agricultural surplus.

But gradually some of the mechanics of the town acquired an independent status of their own. They offered their own wares in exchange. Country barons and squires exchanged their agricultural surpluses for the products of the town's craftsmen. Thus a real exchange developed between country and town.

Exchange process

The breakdown of feudal privileges in the French Revolution developed and expanded this exchange process. The peasant, having acquired a new status, was in a stronger position to retain control over his surplus product. By the time the development of social institutions had reached this point, it was possible to recognize that the country no longer supported the town any more than the town supported the country. It was no longer meaningful to say that agriculture was productive while manufacture was not, or even that agriculture was more productive than manufacture. Both activities satisfied human wants.

But while Adam Smith freed the thinking of his time from the physiocrats' narrow concept of productivity, he failed to liberate himself and his generation wholly from the basic physiocratic error. While urging that manufacturing was equally as productive as agriculture, he nevertheless held that only those workers engaged in making material goods were really productive. Thus, he argued that not only menial servants, but also churchmen, lawyers, physicians, men of letters of all kinds, players, musicians, opera singers, etc., were unproductive laborers. It is remarkable that, once he had taken the first step in the right direction, he should have made

this error. If manufacture is productive, since it no less than agriculture satisfies human wants, surely the opera singer, the physician, the teacher are equally productive. At a later stage in economic thinking the logic of Adam Smith's own position, which he imperfectly applied, was pointed out and universally accepted by all economists.

But the logic of this thesis is frequently challenged with respect to governmental expenditures. Public investments (parks, roads, playgrounds, hospitals), it is often asserted, are in some sense unproductive; only private capital expenditures are regarded as productive.

Sharp distinction

In discussing the productiveness of private business expenditures, it is important to make a sharp distinction between (1) the creation of a flow of real income of goods or services and (2) the creation of new instruments of production which increase the efficiency of labor and result in a larger flow of real income than might otherwise be possible. The former is a utility-creating expenditure; the latter is an efficiency-creating expenditure. Investment which duplicates existing plants in accordance with the requirements of growth (as, for example, the erection of another shoe factory) is of the former type. Investment in improved machinery is of the latter type.

The view that public investment is unproductive, while private investment is productive, will not withstand careful analysis. Public investment, like private investment, may be simply utility-creating or it may be also efficiency-creating. The development of a public park, swimming pool, playground or concert hall makes possible a flow of real income no less than the erection of a shoe factory. Public investment in natural resources or in the construction of school buildings may contribute to raise the efficiency of labor no less than private investment in improved machinery. Public investment, like private investment, if wisely made, may be utility-creating or both utility-creating and efficiency-creating. And in addition to being (1) utility-creating and (2) efficiency-creating, public expenditures no less than private expendi-

tures are also (3) income-creating in the sense that they tend to expand aggregate income and employment.

It is sometimes said that there is an important difference between business expenditures and governmental expenditures, in that the former are self-sustaining while the latter are not. But this will not withstand careful scrutiny. No private business can sustain its sales volume unless the outlays of other businesses or the government continue to feed the income stream. The sales receipts of private business, no less than the tax receipts of government, depend upon the maintenance of a high national income. And the outlays of government can and do contribute to a sustained national income, no less than the outlays of private business. Indeed, when private business outlays decline, the government may be the only agency that is in a position to go forward and sustain the national income through increased expenditures.

When it is said that public expenditures are "sustained out of" private income, it will be disclosed, on careful analysis, that the reasoning is precisely similar to that of the physiocrats. Manufactures were sustained, it was said, out of the surplus product of agriculture. The true fact, however, was that the real income of the community was raised enormously by diverting a part of the productive resources to manufactures. In like manner, under modern conditions, many wants can be satisfied only by governmental action, and in other cases more effectively by governmental action. Roads, streets, sewage disposal, reforestation, flood control, parks, schools, public health, hospitals, low-cost housing, social insurance, public playgrounds, and other recreational and cultural facilities—all these represent ways of enlarging our real income far beyond what it could be if these things were not undertaken by government.

Each segment contributes

These activities are utility-creating and in part efficiency-creating, no less than the activities of private enterprise. The governmental expenditures are not supported out of private enterprise any more than manufacture is supported out of the agricultural surplus. Just as the man-

ufacturing population buys the surplus of agriculture in exchange for its products, so also the services of government enter into the exchange process and enrich the income stream. It is true that part of the exchange payment is in the form of taxes, but this fact in no way alters the fundamental fact of exchange. In this process of exchange it is not true that any one segment of the exchange economy supports any other segment. Manufacturing is not maintained out of the surplus of agriculture and government is not maintained out of the surplus of private enterprise. Each segment contributes to the total flow of real income and each takes its share out of the income stream either by charging a price or by collecting a tax. Outlays create incomes and incomes cover costs.

In the sense that the most essential necessity of life—food—is produced by agriculture, it may be said that



agriculture is basic to all other economic activity. This seems to give it a sort of priority. But this priority has a meaning only in primitive societies where it is necessary to devote all, or nearly all, of productive resources to the procurement of food. As a society becomes more productive, agriculture loses its right of priority. The very superabundance of agricultural products implies that more emphasis must be placed upon other economic pursuits. Manufacture, indeed, may now become the really important branch in that its products are relatively scarce in relation to the products of agriculture. In an agricultural-surplus society manufactures may assert a certain claim to priority.

The same analysis applies to gov-

ernmental activities: once society becomes surfeited with material goods, public needs demand prior consideration.

Income creation

I have discussed the problem of income creation and I have tried to show that the employment of productive resources, whether by government or by private enterprise, involves the payment of money incomes to the employed factors of production. And the income thus paid out is sufficient to buy back all the goods and services produced. Whether this "purchase" comes about via the price-tag mechanism or via taxes is from this standpoint quite immaterial. The costs of production are in fact the income receipts of the factors of production. Incomes spring from costs and expenditures (whether via the price tag or via taxes) spring from income. Costs, income, expenditures—the circle is complete. It is Schumpeter's circular-flow economy.

The publicly provided goods and services are either produced directly under government management or else they are purchased by the government from private producers. Government management could mean either a department like the Post Office Department or a government corporation like the TVA or the Export-Import Bank or the Commodity Credit Corporation. Government purchase of goods and services from private business is illustrated by contract construction work or by the vast governmental purchases of military equipment from private corporations. But whether the government itself produces the goods and services or buys them under contract from private parties, the net effect, as far as income creation is concerned, is the same. Money is paid out which goes into the pockets of individuals, whether wage or salaried workers, or stockholders of the private corporations that do contract work for the government. The entire cost of production is paid out in this manner. The government in its turn recovers the costs thus incurred either by selling the goods and services to the public at a price or else by collecting the cost of their services from the public by means of taxation. ■



Strategy and Arms Control. Thomas C. Schelling and Morton H. Halperin. 148 pp. New York: The Twentieth Century Fund. \$2.50.

• "We use the term 'arms control' rather than 'disarmament,'" write the authors of this thoughtful and stimulating book. "Our intention is merely to broaden the term. We mean to include all the forms of military cooperation between potential enemies in the interest of reducing the likelihood of war, its scope and violence if it occurs, and the political and economic costs of being prepared for it."

Schelling is Professor of Economics at Harvard and a member of the faculty of Harvard's Center for International Affairs; Halperin is a Research Fellow at the Center. They produced this work as a result of a study on arms control supported by The Twentieth Century Fund.

The authors do not present a definite program for arms control; rather, they examine the implications of a number of possibilities. They consider such questions as how to lessen the likelihood of nuclear war by agreements on the type and number of weapons; how nuclear war, if it comes, might be limited by prior agreements; what type of agreements might prevent local wars from breaking out or from spreading once they have started.

Schelling and Halperin concentrate on the military aspect of arms control, but not because they regard the political and psychological aspects as less important. As the authors explain, "We have just not covered the whole subject."

The cost of arms control, they warn, might come high. It might call for greater expenditure on conventional weapons, increased spending on weapons that could not easily be destroyed by a surprise blow, and high costs for the inspection and regulation of military activities.

In all, this book is hopeful in its implications. Arms control, in the sense that the authors present it, seems in the interest of both the United States and the Soviet Union. It may, therefore, be brought about.

The European Common Market. Isaiah Frank. 301 pp. New York: Frederick A. Praeger, Inc. \$8.50.

• This excellent study should be read by everyone interested in European developments or in our foreign trade policies. The author has had extensive experience working with the Department of State on international trade affairs. At present he is in charge of the Office of International Financial and Development Affairs.

Dr. Frank's emphasis, in this book, is on Europe, but the implications for U.S. policy are clear. He points out that, although we have supported European integration, "discrimination against outsiders is the core" of the common market idea. While expanded European income may raise demands for U.S. goods, Europeans should be able to outcompete the U.S. more and more in other markets as their productivity rises and their costs fall.

Perhaps because he is with the State Department, Frank does not go into the possibility that the U.S. may be forced to join some larger economic unit in order to improve its competitive position. Since the political and economic implications of this prospect may be one of the main issues of the Sixties, one rather wishes that he had done so.

American Exports During Business Cycles, 1879-1958. Ilse Mintz. 92 pp. New York: National Bureau of Economic Research. \$1.00.

• The importance of swings in the value of U.S. exports was brought home to most Americans when the gold crisis showed that the dollar was no longer the undisputed king of foreign trade. While this work specifically disclaims any conclusions on the present crisis, it does clarify the historic role exports have played in our economy.

That role has never been proportionately great. Even from 1879 to 1913 exports amounted to less than seven per cent of our gross national product. They fell to a little over five per cent between the wars and to 4.6 per cent from 1949 to 1958.

But shifts from year to year in the

volume of exports have been considerable. Indeed, the 18 per cent annual change widely noted during the export expansion and contraction of 1954 to 1959 is typical for as far back as the study goes.

The author, an economist for the National Bureau of Economic Research, points out that our export cycles have not traditionally coincided with our business cycles. Indeed, before World War I, exports rose as often when U.S. business was falling as when it was rising. Since then the export and business cycles have tended to coincide. But the author attributes this to the fact that, in recent years, the American economy has been more closely connected to the world economy.

While this study is primarily aimed at scholars and those in foreign trade, its nontechnical language makes it understandable to laymen interested in foreign trade or the business cycle.

The Permanent Frontier: An Illustrated History of the U.S. Economy in Action. Haig Babian, Ed. 120 pp. New York: Institute of Economic Affairs, New York University. \$2.95.

• Written by the staff of the Institute of Economic Affairs (the publisher of *CHALLENGE*) under the direction of Haig Babian, this small volume is large in scope—covering the history of the U.S. economy from Columbus to the New Frontier. Various illustrations—in the form of prints, photographs, charts and graphs (both four-color and black and white)—add many revealing side-lights to the material presented in the text.

Tracing the economic development of the U.S. in terms of the frontiers, geographic and otherwise, that confronted our society, the book describes how these were transformed from obstacles to opportunities. Thus, it presents a definite *point of view*. Throughout, the economic history of the country is closely related to its social and political history.

The authors have not neglected to point out the imperfections that became apparent in American society as the U.S. developed from a struggling young nation into a world power. But neither have they neglected to analyze the constructive approaches to such problems that a free society has available to it and which the United States has, at various times in the past, successfully employed.

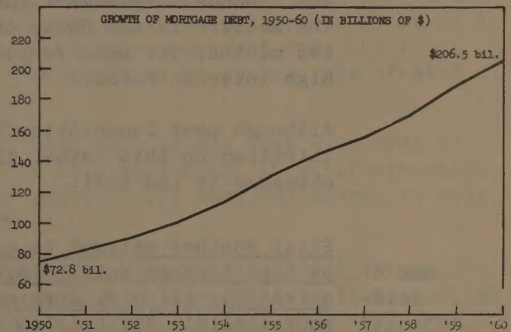
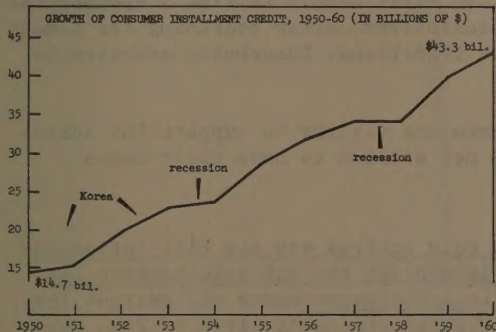
Though particularly appropriate for students in social studies classes, *The Permanent Frontier* should also prove a useful addition to the library of the general reader.



THE DOMESTIC ECONOMY—One of the outstanding developments in the postwar U.S. economy has been the phenomenal growth of consumer installment credit. In the decade of the Fifties alone, outstanding installment debt almost tripled—rising from \$14.7 billion in 1950 to \$43.3 billion in 1960 (see graph below left).

This installment debt increase was accompanied by an almost equally large rise in outstanding mortgage debt which went from \$72.8 billion in 1950 to \$206.5 billion 10 years later (see graph below right).

There were many Cassandras, particularly during the early years of the installment and mortgage boom, who felt that consumer credit was overextended and would result in a rash of defaults in the event of a recession. Experience, however, has proved them wrong.



The average annual delinquency rate has been remarkably steady over the decade—even during periods of recession. It never rose higher than the 2.3% rate reached in both 1950 and 1951, and never fell below the 1.7% rate of 1955 and 1956. Even in the recession years of 1957 and 1958 the average delinquency rate was only 1.8%—even lower than the average rate for the entire 10-year period. The annual rate for 1960 was 2%.

The delinquency rate on mortgages backed by the Federal Housing Administration has, interestingly, fluctuated within the same narrow bands as the delinquency rate in general—a little below or slightly above 2%.

Although the recessions had no effect on the delinquency rate, there was a definite correlation between the downturns in the economy and the rise in the total outstanding debt. In both the 1953-54 and the 1957-58 recessions there was a pronounced leveling off in this long-term rise (graph above left). In other words, while consumers were still able to meet the payments on their existing obligations, they were unwilling to take on new ones during periods of economic uncertainty—at least in the case of consumer durable purchases.

Recessions, however, have just the opposite effect on housing starts. In fact, mortgage credit has become an important countercyclical weapon. As the Federal Reserve lowers interest rates during downturns, prospective home buyers are encouraged by low interest rates to buy immediately instead of waiting.

Lower interest rates during the 1957-58 recession caused new private housing starts to rise from about 1 million in 1957 to almost 1 1/2 million in 1959. This, in turn, started a new boom in installment credit as the buyers began to furnish their new homes.

ECONOMIC NEWS NOTES—President Kennedy has signed a bill exempting from
easing tax liability the interest that foreign central banks receive from
the their investments in U.S. government securities. The measure is part of
payments the Administration's program to ease the balance of payments deficit by
deficit encouraging foreign central banks to keep their funds in U.S. government
securities instead of purchasing gold.

Another part of this program, however, has run into rough sledding in
Congress. This measure would permit U.S. commercial banks to pay more
than 3% interest on the savings-type deposits of foreign governments—
which they cannot do under present Federal Reserve Board regulations.

Although the Federal Reserve is willing to lift the interest ceiling on
deposits of foreign governments, the present law does not permit it to
distinguish between these deposits and those of domestic origin.

The Treasury Department, however, is still unable to find a sponsor for
the measure in the House of Representatives—after searching for almost
two months. The main reason is the traditional Democratic aversion to
high interest rates.

Although most Democratic Congressmen are willing to support the Admin-
istration on this issue, they are not willing to have their names
attached to the bill.

* * *

Still another attempt to ease the gold outflow was the bill introduced
by Rep. Abraham Multer (D.-N.Y.) to abolish the 25% gold backing re-
quired for all U.S. currency and bank reserves. Under the present law,
approximately \$11 billion of the U.S. government's \$17.4 billion gold
supply must be set aside to back our currency.

The purpose of the Multer bill is to convince the world's financial au-
thorities that the U.S. would, if need be, sell every bit of its \$17.4
billion gold supply to maintain the international value of the dollar.

Since the Multer proposal is solidly backed by the Administration, it
has a fairly good chance to pass. Undecided legislators might, however,
be influenced by the attitude of Federal Reserve Board Chairman Martin,
who has not yet expressed his views on the question.

* * *

The House farm bloc has defeated Administration attempts to change the
restricting law governing the employment of Mexican farm laborers in the U.S.

Mexican
farm
labor
About 316,000 such Mexicans entered the country last year to work on
45,000 farms, handling chiefly cotton and vegetable crops in the West-
ern states. The House bill extends, without change, until December 31,
1963, the present law permitting these Mexicans to enter the U.S.

The Administration wanted to restrict the Mexicans to temporary or sea-
sonal employment and require that they be paid wages equal to the pre-
valing pay scales in the locality where they work.

It is possible that the Administration's proposals might eventually be
included in the Senate bill. This, however, would mean the creation of
a joint Senate-House conference committee where the proposals would
almost certainly be watered down.